

INTERNET TAX NONDISCRIMINATION ACT

HEARING
BEFORE THE
SUBCOMMITTEE ON
COMMERCIAL AND ADMINISTRATIVE LAW
OF THE
COMMITTEE ON THE JUDICIARY
HOUSE OF REPRESENTATIVES
ONE HUNDRED SEVENTH CONGRESS
FIRST SESSION
ON
H.R. 1552 and H.R. 1675

JUNE 26, 2001

Serial No. 26

Printed for the use of the Committee on the Judiciary



Available via the World Wide Web: <http://www.house.gov/judiciary>

U.S. GOVERNMENT PRINTING OFFICE

73-474 PS

WASHINGTON : 2001

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: (202) 512-1800 Fax: (202) 512-2250
Mail: Stop SSOP, Washington, DC 20402-0001

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INTERNET TAX NONDISCRIMINATION ACT

TUESDAY, JUNE 26, 2001

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON COMMERCIAL
AND ADMINISTRATIVE LAW,
COMMITTEE ON THE JUDICIARY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:41 p.m., in Room 2141, Rayburn House Office Building, Hon. Bob Barr [Chairman of the Subcommittee] presiding.

Mr. BARR. [Presiding.] If the witnesses could take their seats, we have just a couple of preliminary matters to take care of. And then we'll turn to the main event today, which is testimony on some very important legislation by four very, very distinguished and renowned witnesses.

First of all, I'd like to call this hearing of the Subcommittee on Commercial and Administrative Law to order.

The Chair would like to announce that it has received a request from House Members who are not Members of the Subcommittee to attend today's hearing, pursuant to the rules of the House. While the Chairman of the Committee and its Ranking Minority Member are ex officio Members of every Subcommittee and, therefore, eligible to participate, it has not been the practice of the Committee to offer a participatory role to other Members who are not on the Subcommittee.

However, I am grateful for their interest and attendance and hope that the testimony of the witnesses will be of assistance to them in acquainting themselves with the issues as this legislation proceeds through the legislative process.

The Internet and information technology industries are becoming an increasingly vital component of U.S. economic expansion. According to the U.S. Department of Commerce, information technology industries presently account for 35 percent of real U.S. economic growth.

Internet retail sales continue to accelerate at an impressive rate. In the first quarter of 2001, e-commerce retail sales reached nearly \$7 billion and are projected, conservatively, to reach \$35 to \$40 billion by year's end.

Businesses are developing online sales outlets and expanding their use of networked systems to reach out to consumers in an increasingly digital marketplace. While the government deserves some of the credit for helping create the infrastructure for the new digital economy, excessive regulation and taxation threaten to impede its tremendous commercial potential.

It is this concern that brings us together for today's hearing. In 1998, the Internet Tax Freedom Act was enacted to address some of the many issues and potential problems raised by electronic commerce.

The act imposed a 32Dyear moratorium on Internet access and/or multiple or discriminatory taxes on Internet commerce. This prohibition on Internet-specific taxes has been instrumental in fostering the impressive increase in electronic commerce.

Last year, the Congress considered legislation to extend this moratorium. That legislation received very broad support, passing the House by a vote of 352 to 75. The Senate, unfortunately, did not act on that legislation in the last Congress.

This year, there is little time to delay. In October of this year, a short 4 months away, the moratorium on multiple and discriminatory taxes on Internet commerce expires. In addition, recent weaknesses in the technology sector underlines the importance of maintaining a stable and nondiscriminatory taxing regime in which electronic merchants can successfully compete.

In the absence of a clear Federal prohibition on Internet-specific taxes, inconsistent State taxing policies would burden interstate commerce and cripple the development of this increasingly important commercial medium.

The two bills we consider today at the hearing are tailored to ensure electronic merchants are not singled out for unfair tax treatment. Introduced by Representative Chris Cox, our colleague from California, H.R. 1552 and H.R. 1675 extend the moratorium on multiple or discriminatory Internet taxes while permanently banning taxes on accessing the Internet.

In so doing, they would implement the majority findings of the Advisory Commission on Electronic Commerce, a diverse panel of government and industry representatives whose chairman, Virginia Governor Jim Gilmore, will testify at today's hearing.

Before we begin, I would like to personally welcome the distinguished panel, who will present their views on this important and timely issue.

The Chair now recognizes Mr. Conyers, the Ranking Member of the Judiciary Committee, for an opening statement.

Mr. CONYERS. Thank you, Mr. Chairman. I appreciate that.

Welcome, Governor Engler.

When considering Internet taxation issues, there are two equally important issues that I think should be considered.

First, the question of whether we should extend the moratoriums on Internet access and multiple and discriminatory taxes that we passed in 1998; on this issue, I think almost all the interested parties agree that we should extend the moratorium.

It's difficult to justify multiple and discriminatory taxes under any circumstances on the Internet or otherwise. Extending the moratorium will give us some additional breathing room and allow the States greater opportunity to simplify their own tax structure.

Now the second issue concerns the issue of nexus for sales tax purposes. Now, this is more complex and, in my view, more important.

Pursuant to the Supreme Court's decision in Quill, a State cannot tax a remote seller unless it has a substantial physical pres-

ence in a State. Thus, the traditional brick-and-mortar sellers are required to collect sales tax while the electronic retailers have no such requirement, creating, in my view, an unlevel playing field between the two.

But, unfortunately, this isn't the issue before us today. Today's hearings are on two bills that do not address the critical issue of allowing States to require remote retailers to collect and remit sales taxes.

Extending the moratorium without an attempt to streamline the tax system is merely a delay tactic in making a decision on this issue and would allow the inequitable tax system to continue to the detriment of both the States and the brick-and-mortar retailers.

If we want to truly engage in a serious discussion of Internet tax, we must consider both extending the moratorium and the collection of sales and use taxes on Internet commerce.

Now, the measure to—which I support, which may not get a full audience this afternoon, addresses both the issue of the moratorium and a simplified tax system. It seeks to remedy the unlevel playing field for retailers and brick-and-mortar people by authorizing a short moratorium and authorizing States to develop and enter in an interstate sales and use tax compact. States joining the compact and adopting a simplified sales tax system would be authorized to require remote sellers with a certain sales volume to collect use tax on taxable sales in a State.

So the measure authored by Mr. Delahunt and Mr. Istook, and in which I join, ensures that all retailers, in-store and online, have the same sales tax collection responsibility—the old level playing field.

And so I urge that you keep these humble comments in mind as this hearing proceeds.

And I thank you, Mr. Chairman.

Mr. BARR. I thank the Ranking Member.

The Chair now recognizes the distinguished Vice Chairman of this Committee, the gentleman from Arizona, Mr. Flake, for any opening comments he might be prepared to make.

Mr. FLAKE. Thank you, Mr. Chairman. I have no opening comments. I just look forward to the testimony. Thanks.

Mr. BARR. Thank you.

The Chair recognizes the distinguished gentleman from North Carolina, the Ranking Member of the Subcommittee, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

I'm sorry I was late. I had a little family emergency that I was trying to deal with. And I still haven't dealt with it, so I might have to leave again.

But I just wanted to welcome all the witnesses and thank them for being here.

I'm pretty much in agreement with what Mr. Conyers has said. The bills, as far as they go, dealing with Internet access, taxation of Internet access, really address only part of the problem. And I think it would be in all of our interests to spend some time figuring out how to address the totality of the problem, which is the unlevel playing field between retailers who sell over the Internet and retailers who have fixed locations in the various States.

So I would hope that, as we move along, we can try to pay close attention to both of those issues, not just the extension of the moratorium on access to the Internet, because I think if we do not, we're creating some very, very serious problems for State and local government. And those problems will get worse, not better, over time, as some people will be inclined to abuse the existing system and even divert sales to the Internet that are currently going on out of fixed-location stores.

So I'm looking forward to hearing the witnesses. I appreciate them being here.

If you see me leave, it won't be because of anything any of you said, but because I'm still trying to deal with an emergency that I'm hoping—I can't quite find my wife right now, but she's around somewhere. [Laughter.]

Mr. CONYERS. Oh, that's—you're giving us a clue.

Mr. BARR. I thank the gentleman, the distinguished Ranking Member.

The Chair now recognizes the gentleman from Wisconsin, Mr. Green, for any opening statement he might care to make.

Mr. GREEN. Mr. Chairman, no opening statement, but I look forward to the testimony very much. Thank you, Mr. Chairman.

Mr. BARR. Thank you.

The Chair recognizes the gentlelady from Wisconsin, Ms. Baldwin, for any opening statement she might have.

Ms. BALDWIN. No opening statements. Thank you, Mr. Chairman.

Mr. BARR. I thank the gentlelady.

The Chair recognizes the distinguished gentleman from California, Member of this Subcommittee, Mr. Issa, for any opening statement he might have.

Mr. ISSA. Thank you, Mr. Chairman, and I'll be brief. In the form of a reflection on Mr. Conyers' comment, I think that it does bear understanding on this Subcommittee that the question of nexus and a level playing field has been an area that has needed reform for a long time.

As a recovering manufacturer, making no retail sales, I'm acutely aware, and I believe that our panel has also studied and is aware, that States have attempted for a long time to get nexus, not just against retailers, but against wholesalers. Most States have teams that go to other States and audit, looking for opportunities to gain nexus and gain the ability to levy a huge amount of different taxes.

And so both for Internet but also for other manufacturers—the mail order catalog group is often cited—but real manufacturers who deliver product in all 50 States but only operate from one State are constantly facing the burden of multistate taxation.

So although today will be limited in scope, I believe that this Committee should bear in mind that the final solution on the appropriate way to tax interstate sales, which end up in a particular area of the country, is an issue that has to be carefully researched, so that in fact it cures existing ills rather than creating new opportunities for interstate zero-sum game type of taxation.

Lastly, one must remember that retailers know exactly where they are, and they charge you based on where they are, not based on where the customer comes from. And we could well imagine that

if every single brick-and-mortar retailer had to ask for proof of where you live, and try to substantiate every person coming to their door to find the appropriate taxes, how long the line at check-out would be at the grocery store, for example, in Ohio versus Pennsylvania, where one State taxes food and the other doesn't.

So these problems that often are called a level playing field—in fact, the field is not level, it is confusing, and if we're not careful, we could make it more confusing.

And so I look forward to the panel today to take care of some very narrow and I think bipartisanly acceptable issues. And then I look forward to the opportunity of taking on the bigger issue, but realizing it will take a lot of research if we're going to do it fairly for all our businesses.

Thank you, Mr. Chairman.

Mr. BARR. I thank the gentleman from California, whose background in business certainly uniquely qualifies him to be a very, very important part of this debate.

We have—even though this Subcommittee will be holding—we plan on holding additional hearings on this very important topic over the next several weeks, today we start out with four of the most distinguished witnesses in this area, four gentlemen who bring tremendous and well-recognized expertise to the question of Internet taxation.

It is my privilege and honor of welcoming all four of these distinguished gentlemen today, and it is my further pleasure and honor to introduce the two gentlemen anchoring the witness table today, Mr. Cox and Mr. Comfort.

And then I will turn to two Members of this Subcommittee, who hail from the States of Virginia and Michigan, to extend a welcome on behalf of the Subcommittee to Governor Gilmore and Governor Engler.

Representative Christopher Cox received his undergraduate degree from the University of Southern California, and a graduate degree from Harvard Business School, and his law degree from Harvard Law School, where he was editor of the Harvard Law Review.

Representative Cox was a partner in Latham & Watkins and served as senior associate counsel to President Ronald Reagan prior to being elected to Congress from California's 47th congressional district in 1988. His large and diverse congressional district is one of California's leading high technology exporting regions.

Representative Cox has been at the forefront of congressional efforts to preserve and promote the commercial potential of the Internet. Representative Cox coauthored the Internet Tax Freedom Act of 1998, which prohibits Internet access taxes, as well as Internet-specific State and local taxes, on goods purchased online. This legislation unanimously passed the House in the last Congress.

Earlier this Congress, Representative Cox introduced H.R. 1552 and H.R. 1675 to extend the moratorium created by the 1998 legislation. These bills, both titled the Internet Tax Nondiscrimination Act, are the focus of today's hearing.

Robert Comfort currently serves as Vice President for Tax and Tax Policy at Amazon.com, the world's leading online retailer of books, electronics and other consumer goods.

Mr. Comfort graduated from Princeton University, where he was valedictorian of his class. He obtained his law degree from Harvard Law School, where he was Supreme Court Note editor for the Harvard Law Review.

After law school, Mr. Comfort clerked for Supreme Court Justice Lewis Powell, and was a senior partner in the law firm of Morgan, Lewis & Bockius.

Mr. Comfort has taught law at the University of Pennsylvania and Rutgers law schools and is a member of the American College of Tax Council and the Tax Section of the American Bar Association.

I'd like to welcome Mr. Comfort here today as well.

And I would now like to recognize the gentleman from Virginia, the Commonwealth of Virginia, Mr. Goodlatte, for purposes of introducing his governor and our guest, Governor Jim Gilmore.

Mr. GOODLATTE. Thank you, Mr. Chairman, for allowing me to join your Subcommittee hearing today on this very important subject in which I have a considerable interest as Chairman of the Internet Caucus and as a Member of the full Judiciary Committee, and especially for allowing me the honor of introducing my good friend and my governor, Jim Gilmore.

The governor has fostered a strong relationship between government and the technology community. He established the Governor's Commission on Information Technology, a group that has already made recommendations on Internet policy, resulting in the nation's first comprehensive State Internet policy.

As a result of his leadership on technology issues, Governor Gilmore was chosen to serve as chairman of the Federal Advisory Commission on Electronic Commerce, a panel that was established by the enactment of the Internet Tax Freedom Act, legislation introduced by my colleague from California, Congressman Cox, which I was pleased to help shepherd through the Judiciary Committee.

The Advisory Committee on Electronic Commerce reported its conclusions and recommendations regarding Internet taxation to the Congress in April of last year. I have been very pleased to work with Governor Gilmore and Congressman Cox over the last 4 years to establish and implement many of the recommendations of Governor Gilmore's advisory commission.

I look forward to continuing to work with him and Congressman Cox as we move this legislation forward.

And, Mr. Chairman, I thank you for inviting my governor to speak today. I think he is one of the foremost authorities on this subject. Thank you.

Mr. BARR. I thank the gentleman from Virginia.

I'd like now to recognize, for purposes of introducing our other distinguished governor today, Governor John Engler, recognize the Ranking Member of the Judiciary Committee, the gentleman from Michigan, Mr. Conyers.

Mr. CONYERS. Thank you, Mr. Chairman. I'm happy to have Governor John Engler here.

He's served for many years, completing his eighth year as governor of the State, and has followed these matters very, very carefully.

He's distinguished himself in public office as a State senator of Michigan for many years before he became governor and was, of course, one of those that was considered in the running for the vice presidential nomination in last year's election.

He's also serving presently as vice chairman of the National Governors Association.

And we're happy to have his testimony, because it's based upon an experience that you can only get at the State level, and he's done that.

Now it doesn't matter that redistricting is up in Michigan, and he's the governor of the State. That doesn't bother me a bit. [Laughter.]

And it doesn't lead me to add on any additional commendations and laudatory comments, of which I have several pages here. [Laughter.]

But we'll just put it in the record anyway.

And we're happy, John, to have you with us today in Judiciary Committee.

Mr. ENGLER. Thank you, John.

Mr. BARR. I thank the gentleman from Michigan.

At this time, I would like to turn the podium, as it were, over to our distinguished panel, and ask each one of them, beginning with Representative Cox and then continuing with Governor Gilmore, Governor Engler, and Mr. Comfort, to each take about 5 minutes to state the most important aspects of their testimony, and to let each one of them know, as Mr. Cox certainly is well-aware as a distinguished Member of this body, that their full comments will be included—their written comments will be included in the record.

At this time, the Chair recognizes for 5 minutes Representative Chris Cox of the great State of California.

STATEMENT OF THE HON. CHRISTOPHER COX, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. COX. Thank you very much, Mr. Chairman. And I want to begin by extending my gratitude for your generous comments and introduction.

It is a privilege for me to testify on such a distinguished panel, with Governor Jim Gilmore and Governor John Engler.

And because I was surprised that your introduction was so generous, that it went all the way back to my law school experience, it's especially nice that Mr. Comfort and I actually attended law school together and served on the law review together.

Mr. BARR. As a fellow Trojan, the thought did cross my mind, why you started out at Southern Cal and then went down to Harvard and those other places. [Laughter.]

Mr. COX. Well, of course, we all make mistakes. [Laughter.]

But it's a pleasure to join with Bob Comfort, as well, to work once again after all these years, a quarter century later, on a topic of such importance.

I'm pleased to be back before the Judiciary Committee, to whom the country owes special gratitude for enacting this important legislation that we're talking about extending just 4 years ago.

When I testified 4 years ago, along with Senator Ron Wyden, our purpose was to nip in the bud incipient efforts of some 30,000 tax-

ing jurisdictions to lay claim to a piece of the Internet. Our efforts succeeded thanks to this Committee's work and to the enactment in 1998 of a national moratorium on special, multiple or discriminatory taxes targeting the Internet.

Today, we are here to consider the urgent matter of the expiration of this moratorium. It is only 117 days away.

On October 21, 2001, unless Congress acts and the president signs into law an extension of this moratorium, then all of the things that we were trying to stop can once again overwhelm us.

As we meet today, it is relatively quiet in this hearing and in the country on this subject. No one needs to be concerned because these things aren't happening.

But I assure you that within a matter of days—not just a matter of a year or months, but a matter of days—if we do not act in a timely way, that all Hell will break loose, because it was about to break loose when we acted just in time 4 years ago.

News magazines in 1996, we need to remind ourselves, were warning us that tax collectors around the country were looking to shake down the net. Here are just a few examples of what was about to happen.

Tacoma, Washington, had required Internet service providers to pay a 6 percent gross receipts tax, even for national Internet service providers without any employees in Tacoma. Tacoma's law also required everyone, even foreign sellers, who sold a product over the Internet to anyone in Tacoma to pay a \$72 business license fee.

Vermont and Texas were moving forward to impose more onerous tax collection obligations on merchants who take orders via the Internet than on those who take just telephone orders.

Alabama had classified Internet service as a public utility. As a result, Internet service providers would have to pay, and their customers would have to pay, the same gross receipts tax as BellSouth or as the local water utilities in Alabama.

Florida had imposed a 7 percent tax on the sale of Internet access, plus an additional 2.5 percent tax on the gross receipts from those sales. It was also allowing cities to impose additional telephone fees on Internet access service.

Tennessee began to tax Internet access as an intrastate telecommunications service.

Connecticut began taxing Internet access as a data processing service.

San Bernardino, California, began taxing Internet access as a teletypewriter exchange service.

Chicago began to tax Internet access as a lease of tangible personal property.

And in Texas, the State comptroller had dropped his plan to tax Internet access as a telecom service and was moving forward to tax it as an information service.

Perhaps most fearsome of all was the so-called bit tax, designed to burden only electronic commerce because it would be levied on every bit of digital information transmitted over the Internet—the bigger the file, the bigger the tax.

The Internet Tax Freedom Act stopped this proliferation of confusing Internet taxes, layered one on top of another.

It's important to recognize that it wouldn't matter if you lived in Alabama or Florida or San Bernardino because, as a user of the Internet, you might be hit with each of these little bites, and they would accumulate. And even if the amounts of the levies in and of themselves were small, the threat that they would pose to this means of communication in toto would be substantial indeed.

It's also important to recognize—when I warn about the importance of timeliness, about the importance of making sure that we've gone through the conference committee with the Senate, giving the president his 10 days of time after presentment of the bill to sign it into law, by October 21st, within 117 days, that we recognize that we're not worried about State legislatures rushing in to enact tax laws the next morning. That's unlikely.

But virtually every single one of the things that we're concerned about can be accomplished by bureaucrats, by regulators, by utility commissioners and such, reinterpreting ancient enactments of legislatures that were put on the books long before Al Gore even invented the Internet, if we remember that. [Laughter.]

I can see that time passes and we forget. [Laughter.]

But it is important to recognize that these things can be accomplished by regulation, by a mere stroke of the pen in many cases.

And once a law is on the books, it's very, very difficult to get it off. The grandfather provisions of the current law bear witness to the fact that once a tax is placed on the books, we're going to have a heck of a time taking it off the books, particularly if it's the Federal Government telling State government or local government that they can't do that.

This is a very delicate area and making sure that we don't take bread off of anyone's plate is an essential ingredient in our ultimate success.

So, if I may summarize, Mr. Chairman, keeping, as Mr. Conyers said, discriminatory taxes off the Internet is something that everyone should be able to agree with. Even for those people who disagree about the correct standard for nexus, we ought to be able to agree that everyone should be treated the same way, whatever the standard is. And that's why rapidly extending this moratorium, hopefully permanently, is so urgent.

I recommend to each of the Members of this Committee this legislation, and thank you all for your past interest in this topic and for your support of this legislation in the past.

I look forward to working with you to renew this moratorium before it expires on October 21, 2001.

And I thank the Chairman of the Committee.

[The prepared statement of Mr. Cox follows:]

PREPARED STATEMENT OF THE HONORABLE CHRIS COX, A REPRESENTATIVE IN
CONGRESS FROM THE STATE OF CALIFORNIA

Thank you, Chairman Barr and Mr. Watt, for holding this hearing today, and for giving me the opportunity to testify on such a distinguished panel, together with Gov. Jim Gilmore and Gov. John Engler, about our common interest in protecting the Internet from special taxation.

I'm pleased to be back before the Judiciary Committee on this issue. When I testified before this Committee four years ago on the original Internet Tax Freedom Act, our purpose was to nip in the bud the incipient efforts of some 30,000 taxing jurisdictions to lay claim to a piece of the Internet. And our efforts succeeded, thanks

to the enactment in 1998 of a national moratorium on special, multiple, and discriminatory Internet taxes.

Today, we are here to consider whether this has been a sound policy for our country, and to decide whether to renew this national moratorium, which expires in only 117 days, on October 21, 2001.

Last year, the Committee reported legislation to extend the moratorium, and the full House voted overwhelmingly, 352-75, to approve the legislation. Unfortunately, because the Senate failed to act on the bill, I am before you once again to urge your support for extending the moratorium—and renewing our national commitment to ensuring that the Internet isn't singled out for special taxes.

Extending the moratorium is especially important at a time when so many high-tech and e-commerce companies are struggling to raise capital and make ends meet. Failure to renew the moratorium will tell the high-tech sector of our economy that it is "open season" for special Internet taxes, and send a message to state and local tax authorities that new, multiple, and discriminatory Internet taxes may be levied with impunity.

That's why it's so critical that we act, and act quickly.

Back in 1996, when Ron Wyden and I first began drafting the Internet Tax Freedom Act, our interest was to ensure that the Internet not fall victim to the tyranny of the parochial, and get caught up in an inconsistent patchwork of taxes by thousands of different taxing jurisdictions. Concerned that the Internet's global nature and decentralized architecture make it inherently *vulnerable* to multiple and special types of taxation, we did not want to see it drown in a sea of red tape, tax compliance paperwork, and revenue exactions.

Back in 1996, these concerns were real. News magazines warned that tax collectors around the country were looking to "shake down the Net." Here are just a few examples of how governments were trying to tax the Internet:

- Tacoma, Washington had required Internet service providers to pay a 6% gross receipts tax, even for national ISPs without any employees in Tacoma. Tacoma's law also required everyone—even foreign sellers—who sold a product over the Internet to a Tacoma resident to pay a \$72 annual business license fee.
- Vermont and Texas were moving forward to impose more onerous tax collection obligations on merchants who take orders via the Internet than those who just take telephone orders.
- Alabama had classified Internet service as a public utility, requiring ISPs to pay the same gross receipts tax rate as Bell South and local water utilities.
- Florida had imposed a 7% tax on the sale of Internet access, plus an additional 2.5% tax on the gross receipts from such sales, and was also allowing cities to impose additional telephone fees on Internet access services.
- Tennessee began to tax Internet access as an intrastate telecommunications service; Connecticut began taxing Internet access as a data processing service; San Bernardino, California began taxing Internet access as a teletypewriter exchange service; Chicago began to tax Internet access as a lease of tangible personal property; and in Texas, the state comptroller had dropped his plan to tax Internet access as a telecom service, but was now moving forward to tax it an information service.
- Perhaps most fearsome of all was the so-called "bit tax," designed to burden only electronic commerce, because it would be levied on every bit of digital information transmitted over the Internet. While largely discredited today, five years ago it was discussed in state tax circles with considerable enthusiasm.

The Internet Tax Freedom Act stopped this proliferation of confusing Internet taxes layered one on top of another. The law enacted in 1998 does *not*, as is often inaccurately reported, preclude *all* taxation of electronic commerce. Instead, the law bars *only* three types of taxes:

- First, Internet access taxes (that is, taxes on the fees that consumers pay to connect to the Internet).
- Second, multiple taxes on electronic commerce (that is, two or more taxing jurisdictions trying to double-tax the same sale).
- Finally, discriminatory taxes on electronic commerce (that is, taxes that apply only to the Internet and not to the offline world).

The two bills before you today, H.R. 1552 and H.R. 1675, would both extend the Internet tax moratorium. The former bill would extend for five years the ban on

multiple and discriminatory taxes, and would permanently extend the ban on Internet access taxes. The latter bill would extend the entire moratorium permanently, and it is this bill that I am especially interested in urging you to consider.

A permanent extension is preferable precisely because the existing moratorium does not overreach. Because it bars only Internet access and other specialized Internet taxes, its fundamental structure is ideally suited to become permanent policy. Whatever disagreements there might be on other aspects of the Internet tax debate, I hope we can all agree—as a starting point—that the Internet should *never* be subject to new, multiple, or discriminatory taxes.

Enshrining these basic principles into permanent law also makes sense even if the Supreme Court's physical-presence rule were to one day be overturned. Even for people who disagree on what "nexus" standard is most appropriate—whether the current physical-presence rule, or some other standard—surely there is agreement that all remote sellers should be treated under the same standard. None of us wants a regime that treats the same seller differently if he sells by catalog or over the Internet.

Today, as the end date for the moratorium draws near, and as capital has been diverted from firms pursuing Internet development, it is more critical than ever to renew the Internet tax moratorium, and to reassure all Americans that government will not place special burdens on the new economy. I commend the Chairman, Ranking Member, and the members of this Committee for their past interest and support, and look forward to working with you to renew the moratorium on special, multiple, and discriminatory Internet taxes.

Mr. BARR. Thank you, Mr. Cox.

Governor Gilmore, thank you for being here. We appreciate your being here and look forward to your taking 5 minutes to state, for the record, important aspects of your testimony.

STATEMENT OF THE HON. JAMES S. GILMORE III, GOVERNOR OF THE COMMONWEALTH OF VIRGINIA, AND CHAIRMAN OF THE ADVISORY COMMISSION ON ELECTRONIC COMMERCE

Governor GILMORE. Thank you, Mr. Chairman.

Mr. Chairman, Ranking Member Watt, Congressman Flake, Congressman Conyers, Members of the Committee—and particularly thank you, Congressman Goodlatte, for your generous introduction—thank you for inviting me to speak here today on the importance of maintaining a tax-free Internet and to urge passage of—I want to urge passage of H.R. 1675 and H.R. 1552.

First, I want to recognize your colleague, Representative Chris Cox, for his vision and his hard work on behalf of taxpayers and, of course, in stirring up the ire of Members of the Committee before I speak. [Laughter.]

Thank you very much, Chris. [Laughter.]

But also, his work on behalf of Internet entrepreneurs all over the United States by sponsoring the Internet Tax Freedom Act.

In addition to establishing a 3-year moratorium against discriminatory taxation of electronic commerce and Internet access taxes, the Internet Tax Freedom Act established Congress's Advisory Commission on Electronic Commerce, and I had the distinct honor of serving as Chairman of that commission last year.

The commission delivered a report to Congress last April, and I'm proud of the innovative ideas proposed in this report. I'm sure many of you have received a copy of it. This report proposed to keep the Internet free of onerous tax burdens and thereby expand America's digital horizons in the 21st century.

As you're aware, this commission fostered a very robust debate, and consensus proved illusive on very many of these issues. But every person on the commission recognized at least one simple

principle: Our national economy, U.S. global competitiveness, and American culture depend vitally upon nurturing full development of the Internet and the information technologies that make it work.

A clear majority of the commissioners took the position that the tax burdens—both the taxes paid by consumers and the cost of tax compliance paid by Internet entrepreneurs—would thwart this central objective of realizing the Internet's full potential as a revolutionary tool of commerce. These commissioners supported tax freedom on the Internet.

The commission's report includes many policy proposals, which I have summarized in my written submission to this Committee. They range from eliminating the Federal 3 percent telephone tax and updating nexus rules to protect businesses from unfair exposure to business activity taxes in a cyber economy, to promoting wider public access to the Internet for all people.

For the purposes of addressing H.R. 1675 and H.R. 1552, which are the subject that is before the Committee today, I'd want to focus on two key policy proposals reported by the advisory commission.

First, Congress should extend the current moratorium on multiple and discriminatory taxation of electronic commerce for at least 5 additional years. This was a part of our report.

Second, Congress should make permanent the current moratorium on Internet access taxes, including those access taxes grandfathered, by the way—which were grandfathered by the previous Internet Tax Freedom Act, in order to reduce the price of Internet access, empower citizens and consumers across the country to take advantage of digital opportunities and participate in electronic commerce without cost-prohibitive tax burdens, which, by the way, would also help us to close the digital divide and make sure that it didn't widen any further.

H.R. 1675 and H.R. 1552 accomplish both of these policy objectives reached by the commission. In my view, Congress can take a giant leap toward maintaining a tax-free Internet and fostering digital opportunities for individual citizens by passing Congressman Cox's H.R. 1675 or H.R. 1552.

H.R. 1675 is especially constructive, because it would codify permanent tax protections for the Internet in two important aspects. First, this legislation will extend the moratorium against multiple and discriminatory taxes targeted at the Internet. And, second, it would eliminate all access taxes currently imposed upon Internet access.

Regarding the moratorium against multiple and discriminatory taxes, it will be important to allow electronic commerce to grow uninhibited by new and complex tax burdens and theories.

It would be wise for us to heed the admonition of President Ronald Reagan two decades ago when he said: The government's view of the economy could be summed up in a few short phrases. If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it.

Well, in the new economy of the 21st century, what's moving is the Internet. Unfortunately, government's 20th century impulse is to tax it.

These impulses, if not checked by Congress, would stop the Internet dead in its tracks in the 21st century. The threat is real, and the consequences are serious for our national prosperity.

If the Internet is to achieve its full potential, Congress should protect the Internet and the American people engaged in electronic commerce from the many forms of new and innovative taxation.

Some people in the United States and in Europe have proposed to tax each bit and byte of electronic data an individual sends or receives on his computer. Others have proposed to tax each Web page or Web-hosting service. Others have proposed to impose taxes on electronic information accessed on the World Wide Web.

In the process of trying to harness taxes to electrons traveling through wires and routers and hard drives, this leads to confusion and debate and argument as to what in the world is taxable and what is not, and what has a real-world corollary and what does not.

The result would be patently discriminatory. License taxes, gross receipt taxes, excise taxes, business activity taxes, fees—all these creative forms of taxation and the attendant compliant costs are threats to electronic commerce as thousands of tax collectors across the country devise new tax theories to capture activity in the cyber economy.

The current moratorium expires in October of this year. It's imperative that Congress extends the moratorium permanently, or at least for 5 additional years, to allow electronic commerce to advance technologically and economically.

Gentlemen, regarding the prohibition against access taxes—ladies and gentlemen—people should not be forced to pay a tax just to log on the Internet. Most Americans use their telephone lines to connect to the Internet, and they're already paying significant telephone taxes on that connection.

As policymakers, we should not impose a second layer of taxation on each consumer's monthly Internet access charge. We can't permit double taxation on people's access to the Internet in an information economy. On the contrary, government should be looking for ways to reduce the cost of each citizen's access to the Internet.

Unfortunately, many States and localities currently impose taxes on Internet access, and they're already clogging the information superhighways. H.R. 1675 would prohibit these taxes.

Mr. Chairman, thank you very much.

[The prepared statement of Governor Gilmore follows:]

PREPARED STATEMENT OF THE HONORABLE JAMES S. GILMORE III

INTRODUCTION

Chairman Barr, Ranking Member Watt, and distinguished members of the Commercial & Administrative Law Subcommittee, thank you for inviting me to speak today on the importance of maintaining a tax free Internet and to urge passage of HR 1675 and HR 1552.

First, let me recognize your colleague, Representative Christopher Cox, for his vision and hard work on behalf of taxpayers and Internet entrepreneurs all over the United States by sponsoring the Internet Tax Freedom Act. In addition to establishing a three-year moratorium against discriminatory taxation of electronic commerce and Internet access taxes, the Internet Tax Freedom Act established Congress' Advisory Commission on Electronic Commerce. I had the distinct honor to serve as Chairman of the Commission last year.

The Congress took great care in appointing distinguished leaders representing diverse perspectives from both the public and private sector. They included several distinguished leaders from the private sector: Michael Armstrong of AT&T, Grover Norquist of Americans for Tax Reform, Richard Parsons of Time Warner, Bob Pittman of AOL, David Pottruck of Charles Schwab, John Sidgmore of MCI WorldCom and UUNet, Stan Sokul on behalf of the Association of Interactive Media, and Ted Waitt of Gateway all served with distinction. And they include an equally impressive group from the public sector representing state and local governments: The public sector representatives were equally impressive and included Dean Andal, Chairman of the California Board of Equalization, Delegate Paul Harris of the Virginia General Assembly, Commissioner Delna Jones of Washington County, Oregon, Mayor Ron Kirk of Dallas, Texas, Governor Mike Leavitt of Utah, Gene LeBrun of the Commissioners on Uniform State Laws, and Governor Gary Locke of Washington State. There were also three representatives from the Clinton Administration.

These Commissioners devoted thousands of hours and their creativity to produce a Report for Congress last April, and I am proud of the innovative ideas we proposed to keep the Internet free of onerous tax burdens and expand America's digital horizons in the 21st Century. A copy of that report was forwarded to every Member last year, and it has been archived on the web by the George Mason University Law School at www.gmu.edu.

THE INTERNET IS DRIVING THE NEW ECONOMY

A year of study confirmed at least a few important principles.

The Internet is the most transforming economic development since the Industrial Revolution. The explosion of new information technologies was responsible for America's economic boom in the late 1990s. The information technology sector of the economy continues to contribute significantly to the economic growth of this country. It created new jobs, increased productivity and efficiencies in every sector of the economy, and continues to generate new wealth in America. For the first time ever, consumers can locate perfect information and access to goods and services at the touch of a button, and small businesses and entrepreneurs can—for the first time in history—reach a global marketplace and compete with big, capital intensive companies. The result is a digital marketplace even Adam Smith would marvel. And even as we experience a slow down in our economic growth, the economic benefits derived from new information technologies continue to cushion the downturn.

The Internet does not just facilitate commerce—it *creates new commerce*. Even in rural areas long ago ignored by the economic progress in metropolitan areas and bypassed by the Nation's huge investment of public resources on the interstate highway system, small businesses are prospering by selling products worldwide.

The Virginia Diner in rural Wakefield, Virginia, is a perfect example. The nation's huge investment of tax dollars in the interstate highway system left Rt. 460, a classic small town "Main Street," virtually abandoned years ago. Those people who happened through Wakefield could stop into the Virginia Diner and buy a cup of coffee and a can of Virginia peanuts. But the Internet economy has empowered *VaDiner.com* to sell Virginia peanuts to consumers from Spain to California to Tokyo. Due to the boom in Internet sales, the Virginia Diner has increased its employment in Wakefield from 70 to 120 employees over the last three years and this year the Diner will invest over \$100,000 in new computer hardware and software.

The Internet changes everything. More to the point, the Internet changes everything *including government*. Old rules do not work well in this new borderless economy. Sometimes they do not work at all. Regardless, change is everywhere, and government has to change as well.

In the Internet economy, government at all levels must change its *policies* as well as *the way it operates*. The Internet is driving a 15 percent increase in revenues and productivity per employee in the private sector economy, according to the University of Texas' Center for Research. Government must marshal the Internet to become equally as productive per public employee in the delivery of government services. The result should be a dividend to American taxpayers through lower-cost, more efficient government. The savings should be re-prioritized to other government services so that no city goes without fire trucks or schools, and taxes should be kept low.

POLICY PRESCRIPTIONS FOR THE 21ST CENTURY

The point is one every person on the Commission recognized: our national economy, U.S. global competitiveness, and American culture depend vitally upon nur-

turing full development of the Internet and the information technologies that make it work.

That brings me to policy prescriptions for the 21st Century economy.

I point out that the some of the Commission's policy proposals came to the Congress by way of a two-thirds vote—the statutory hurdle for a proposal to take on the elevated status as a formal “recommendation” or “finding.” On issues such as international tariffs, consumer privacy, and the digital divide, we came to two-thirds votes, though I was disappointed representatives from the Clinton Administration abstained on these consensus issues. On a host of core tax issues, the Commission came to a clear majority by a vote of 11 to 1 (with 7 votes abstaining) and those proposals are included in the Commission's Report.

Let me provide one disclaimer regarding my personal opinion, which is the position I advocated within Commission debates. I believe that no taxation is presumptively necessary. To the contrary, the presumption should favor the right of individual citizens to keep their own hard-earned money. Government must prove a tax is absolutely necessary for the provision of essential services before taxing a new realm of economic activity or human endeavor. Government has no right to expand tax burdens on Americans just because a similar commercial transaction is taxed. Government should take only what it needs to operate government and stop there.

And in the context of electronic commerce, America's response to the Internet revolution should NOT be to tax it or all the people—the individual taxpayers, consumers and small businesses—who have been empowered by it. In my view, the history of the 20th Century was about bigger government built at the expense of hard-working people. But the 21st Century offers the promise of smaller, more efficient government and a proportionate increase in the economic freedom and liberty of individual people who are permitted to keep more of their own money.

Since I presented the Advisory Commission on Electronic Commerce report on behalf of the Commission last April, we find ourselves at a much different point in the national economic cycle. The technology driven boom has slowed and while entrepreneurs and innovators still flourish, we are in a period of consolidation and one of much slower and hopefully sustainable growth. Nevertheless, the opinions expressed by a majority of Commissioners during the course of our deliberations are just as relevant today—perhaps even more so—particularly because we must be very careful before initiating policies that threaten the growth of this sector.

When the Commission first began its charge early in 1999, the sales tax collection issue on remote sales was looming large—not because of the impact that it was having, but because of its *potential* to effect the revenue sources that state and local governments have long depended upon. Internet sales at that time represented only .64% of all retail sales. By 2003 it was predicted that figure would mushroom rapidly and the Internet would dominate a whopping 15% of retail sales. The alarm was sounded—something had to be done lest local governments cease to operate! The answer for many was clear, taxing authority had to be expanded beyond individual state borders to stem the tide of lost revenue.

And so here we are, halfway through 2001, once again assessing the state of the economy, and trying to make some decisions as to the appropriate course of action as it relates to sales taxes and the Internet. There are many places we can look for guidance. The United States Department of Commerce recently released its most current retail sales figures. For the 4th quarter of fiscal year 2000, retail sales on the Internet still represent less than one percent, just .91% of total retail sales. That is quite a long way from the predictions of market dominance we heard just a year ago and quite a long way too from representing a serious threat to the revenues of state and local governments—and yet the alarm bells are still being rung.

If nothing else, the past year has demonstrated that we do not have all the answers—this industry is in a period of flux and consolidation. Many of the large pure play Internet retailers are no longer with us. Their business models were simply not sustainable—for a variety of reasons. For many, their lack of physical presence made it difficult to service their customer base.

Many of the survivors are now partnering with traditional retailers to take advantage of their distribution networks and economies of scale. Others, like Amazon.com, have found that success requires capital intensive investments in multi-state warehouse facilities or storefronts in order to provide hands on customer attention and rapid delivery service and in the process, they are availing themselves of a variety of public services and voluntarily exposing themselves to sales tax requirements in those states where they have established a presence in the community. So while politicians of every sort debate the merits of various sales tax proposals, the market place is evolving and as a result we may find that many of these questions are being answered for us if we will just stop for a moment and listen to reality. It may not happen as quickly as some wish—but it is happening without artificial disruption

of the marketplace and without the federal government instructing a federal policy as to state sales taxes.

The evolution of the information technology sector illustrates that the sales tax “problem” as defined by local governments remains for the time being temporary at best. Temporary because the portion of Internet sales relative to all retail sales is still insignificant. Temporary also because the technology sector is dynamic and despite its significant contributions to our national economy, it is still in an early developmental stage. With this in mind, I believe it is important that Congress and the states move carefully with regard to proposals that will on a wholesale level have a deleterious effect on the interstate commercial structure of our electronic commerce and federal system. Before we head in that direction, we better be certain that the technology sector can sustain any new tax burdens.

That opinion was not shared universally on the Commission. Nevertheless, a majority of Commissioners approved policy prescriptions that, in my view, advance these objectives.

Among the ideas submitted in the Commission’ Report, you will find proposals for the following tax cuts and tax reforms:

- First, Congress should extend the current moratorium on multiple and discriminatory taxation of electronic commerce for at least an additional five years through 2006.
- Second, make permanent the current moratorium on Internet access taxes, including those access taxes grand fathered under the Internet Tax Freedom Act. This proposal is another crucial initiative, targeted to reduce the price of Internet access and to close the digital divide. By expanding the moratorium to eliminate the current grandfather provision, consumers across the country would participate in electronic commerce without onerous tax burdens.
- Third, prohibit taxation of digitized goods sold over the Internet. This proposal would protect consumer privacy on the Internet and prevent the slippery slope of taxing all services, entertainment and information in the U.S. economy (both on the Internet and on Main Streets across America). Moreover, this tax prohibition is essential to maintaining U.S. global competitiveness since the United States currently dominates the world market in digitized goods.
- Fourth, establish “bright line” nexus standards for American businesses engaged in interstate commerce. The cyber economy has blurred the application of many legal nexus rules. American businesses need clear and uniform tax rules. Therefore, Congress should codify nexus standards for sales taxes in a way that adapts the law of nexus to the New Economy and the new “dot com” business model. Codification of nexus would serve several important policy objectives: (1) provide businesses “bright line” rules in an otherwise confusing system of state-by-state nexus rules; (2) protect businesses, especially small businesses, from onerous tax collection burdens; (3) reduce the amount of costly litigation spurred by confusing nexus rules; (4) nurture the full growth and development of electronic commerce; and (5) give consumers and individual taxpayers who participate in Internet commerce a tax break.
- Fifth, clarify existing federal protections against the unfair imposition of business activity taxes for businesses engaged in interstate commerce over the Internet.
- Sixth, place the burden on states to simplify their own labyrinthine telecommunications tax systems as well as sales and use tax systems to ease burdens on Internet commerce. This effort will be particularly important for small and medium-sized retailers with nexus in two or more states. It also will be important for telecommunications companies as they build out the Internet infrastructure and offer new technologies and services. Radical simplification will be necessary in the New Economy if small and medium-sized businesses are to succeed.
- Seventh, eliminate the regressive 3% federal telephone tax. The federal telephone tax on each consumer’s local and long distance charges each month was first imposed as a luxury tax on the few Americans who owned a telephone in the late 1800s—to fund America’s efforts in the Spanish American War. The tax was scheduled for extinction almost every year throughout the 20th Century, and Congress voted to abolish it last year, but President Clinton vetoed the tax cut. The federal telephone tax remains a tax on Internet access since most Americans access the Internet over telephone lines.

- Eighth, clarify state authority to spend TANF funds to provide needy families access to computers and the Internet, as well as the training they need to participate in the Internet economy. This is one strategy the Commission formally recommends to close the digital divide and make the personal computer and access to the Internet as ubiquitous as the telephone and television.
- Ninth, provide tax incentives and federal matching funds to states to encourage public-private partnerships to provide needy citizens access to computers and the Internet. This is yet another strategy the Commission formally recommends to close the digital divide.
- Tenth, respect and protect consumer privacy in crafting any laws pertaining to online commerce generally and in imposing any tax collection and administration burdens on the Internet specifically. This is a formal recommendation of the Commission.
- Eleventh, continue to press for a moratorium on any international tariffs on electronic transmissions over the Internet. This idea also is a formal recommendation of the Commission.
- And twelfth, a majority of the Commission endorsed a comprehensive framework for addressing international tax and tariff issues based upon the following core principles: no new taxes or tax structures on electronic commerce in the world marketplace; tax neutrality toward electronic commerce; simplicity and transparency of tax rules applied to electronic commerce; and a call for the Organization of Economic & Community Development (OECD) to continue fostering international dialogue and cooperation on international tax issues.Q04

These are the key ideas generated in a year of open debate and thorough study. Taken together, these ideas comprise a comprehensive package of policy proposals to inform Congress of the array of tax issues implicated by the Internet. Consistent with direction from Congressional leadership, the Commission provided Congress a bold and constructive foundation for legislative action that will have a tangible and positive impact on the lives of working men and women and their families.

HR 1675 IS CRITICAL TO MAINTAINING A TAX-FREE INTERNET

Hopefully, the Commission's ideas will leave a lasting legacy for a new way of thinking for a new century.

Congress can start by passing Congressman Cox's HR 1675, or a similar bill, HR 1552.

In the immortal words of President Ronald Reagan, "The government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

In the New Economy, what's moving is the Internet, and, unfortunately, government's 20th Century impulse is to tax it. But government's 20th Century impulses, if not checked by Congress, would stop the Internet dead in its tracks. The risk is real and, if the Internet is to achieve its full potential, governments must curb their insatiable appetites for more tax dollars.

HR 1675 will provide the American people engaged in electronic commerce broad protection from all sorts of new and innovative tax schemes. HR 1675 will protect electronic commerce and the Internet from costly and burdensome taxation in two important respects:

- First, this legislation will extend the moratorium against "multiple and discriminatory" taxes targeted at the Internet; and
- Second, it will eliminate all "access taxes" currently imposed upon Internet access.

These tax protections are critical to maintaining a tax-free Internet and they are consistent with the Commission's Report.

First, regarding the moratorium against "multiple and discriminatory" taxes, it will be important to allow electronic commerce to grow uninhibited by new and complex tax burdens and theories. License taxes, gross receipts taxes, fees. . . all of these creative forms of taxation and their attendant compliance costs are threats to electronic commerce and should be prohibited. The current moratorium in the Internet Tax Freedom Act expires in October of this year. It is imperative that Congress extend the moratorium permanently or for at least five additional years to give electronic commerce time to advance technologically and economically before the taxman targets electronic forms of commerce for new, unique, and multiple forms of taxation.

Second, regarding the prohibition against access taxes, people should not be forced to pay a tax just to log on the Internet. Since many people log their telephone lines to connect to the Internet, they already pay significant taxes on that connection. We should not permit zealous tax collectors to impose a second layer of taxation on each consumer's monthly Internet access charge—we cannot permit double taxation on people's access to the Internet in an information economy. To the contrary, government should be looking for ways to reduce the cost of each citizen's access to the Internet. This objective is critical to expanding Internet access and closing the digital divide.

Clearly these policy proposals represent two critical steps forward in America's efforts to expand Internet access to all people, encourage the outgrowth of electronic commerce in the United States, and relieve the people of the United States of onerous tax burdens.

Therefore, I urge your support for HR 1675.

Thank you for inviting me and I would be happy to answer any questions.

Mr. BARR. Thank you, Governor Gilmore.

Governor Engler, we're very happy to have you with us today. If you would take 5 minutes and provide testimony. And again, your written testimony, as with the other witnesses, will be made a part of the record.

**STATEMENT OF THE HON. JOHN ENGLER, GOVERNOR OF THE
STATE OF MICHIGAN, ON BEHALF OF THE NATIONAL GOV-
ERNORS ASSOCIATION**

Governor ENGLER. Thank you, Mr. Chairman. Thank you, Mr. Chairman and Members of the Committee. I am——

Mr. BARR. Is the mike on?

Governor ENGLER. There we go.

Mr. BARR. Thank you.

Governor ENGLER. Thank you, Mr. Chairman and Members of the Committee.

On behalf of America's governors, I am here to report that, to my knowledge, there are no State or local governments interested in imposing new access taxes to the Internet. What State and local governments are interested in, however, is tax simplification and tax fairness.

Governors understand, as you do, that the Internet is an incredibly powerful tool. Access to this new public square must continue to be open and unhindered. The Internet should not be a way for buyers and sellers of goods to avoid existing obligations to pay sales or use tax.

That's why America's governors urged the Congress to enact legislation giving the States the authority to require remote sellers to collect and remit sales and use taxes.

We know that the current sales and use tax collection systems must be simplified to implement our proposal. Indeed, 13 States—in my written testimony, but since submitting that, it's now 15 States, with the addition of Florida and Texas, have adopted model legislation to simplify their systems and reduce the complexity and cost of collection. The details of the model legislation are included in my written testimony.

Highlights include centralized, one-stop, multistate registration; uniform definitions for goods and services; and, uniform rules for attributing transactions to particular taxing jurisdictions and for dealing with exempt transactions.

We are proposing a partnership between the States and the Federal Government that achieves our goals of fairness and simplicity.

When States adopt a streamlined and technologically efficient tax system, the Federal Government should cooperate and allow the States to require remote sellers to collect those taxes.

And I would note that Senator—that Congressman Conyers mentioned earlier how H.R. 1410, introduced by Representatives Istook and Delahunt and, importantly, a major cosponsor, the Ranking Member of the Committee—and we thank you for that, Mr. Conyers—that the governors do support those simplifications that are contained in that legislation.

And we think that legislation—your legislation—would save the nation's economy millions of dollars by modernizing the tax system. The simplifications in that bill are consistent with many of the efforts now being undertaken by the Streamlined Sales Tax Project.

I want to be clear on one point, because I know it is central to the moratorium. I'm not talking about new taxes, a tax increase, or taxing the Internet. I would oppose such ideas.

However, of the 45 States that levy sales taxes, all 45 have a use tax and require that to be paid if a customer's purchase is made online or out-of-state. Under current legal standards, a State may impose sales and use tax collection requirements only on those sellers with a physical presence or nexus in the State, whether the transaction is over the Internet or through a catalog.

As a result, remote sellers are able to exploit markets in States, whether by mail, telephone or Internet, without being required to collect or remit taxes on their sales into the State. Sellers that are physically present in the State are required to collect and remit the tax.

It has no impact on the purchaser's liability. That's the same in either situation. It's just on collection.

Obviously, not collecting the use tax on electronic transactions is an incentive for merchants to use electronic or Internet transactions. As e-tailing versus retailing continues to grow in popularity, the imbalance and the unfairness to Main Street retailers will continue to grow.

And I suspect it wouldn't be too long before sophisticated Main Street retailers can respond. Consider this example for a moment: A customer walks into a downtown department store, picks out a pair of jeans but doesn't pay for them at the counter. He goes to an in-store Internet kiosk, and then pays over the Internet. The clerk puts the jeans in a bag and out you go without paying the sales tax.

Many of America's major e-tailers are already partnering with major retailers. And the tax savings for their companies are one key advantage that this partnership could provide if the strategic unions of e-tail and retail could become commonplace.

The bottom line is that eventually the State and local sales and use tax gets to be rendered obsolete, inefficient as a source of revenue for State and local governments. This would be especially true for public schools, which has been a priority of this Congress.

Of course, the retailers who continue to collect the tax continue to support the United Way, the local charities, the local churches. Even the faith-based programs that the president yesterday spoke about in Detroit to the U.S. Conference of Mayors, they end up being rendered obsolete. And the devastation is pretty profound on

the backbone of Main Street America and to the people that would have been formerly employed in those situations.

Let me just close with this example, though. It isn't always the same.

A business traveler—probably some in the audience today—wanted to buy an airline ticket from somewhere in America to come here to Washington, DC. Instead of calling a travel agent, the traveler went online, bought an e-ticket. Northwest Airlines sells 65 percent of their tickets that way. Every single passenger who bought that ticket and then took that flight paid the Federal airline ticket tax, and they paid that whether they bought online or they went through a travel agent.

I'd also point out the Federal excise taxes on cigarettes, tires, and liquor that are purchased online are collected very efficiently.

And I would suggest: What's different about that pair of jeans in my example than cigarettes, tires, liquor, and airline tickets?

Thank you, Mr. Chairman.

[The prepared statement of Governor Engler follows:]

PREPARED STATEMENT OF THE HONORABLE JOHN ENGLER

Mr. Chairman, on behalf of America's Governors, I am here to report that to my knowledge, there is no state or local government interested in imposing new access taxes to the Internet. What state and local governments are interested in, however, is tax simplification and tax fairness.

I have worked long and hard to encourage Washington to return power and authority back to the states and local governments. This notion of a new federalism was best represented in welfare reform, which has been an unqualified success. When given the responsibility, states responded with accountability and innovation.

Legislation enacted during the past five years demonstrated that the federal government could build incentives for adaptability and performance and delegate substantial decisionmaking authority to states. Actions include:

Welfare Reform—Perhaps the most significant example of devolving program responsibilities from the federal government to state governments is the 1996 welfare reform law. This law resulted from the strong leadership role played by states and the pressure exerted to implement a federal waiver process to develop innovative welfare reforms. The 1996 law repealed the Aid to Families with Dependent Children (AFDC) program, which had existed for more than thirty years, and created a new Temporary Assistance for Needy Families (TANF) block grant. Under AFDC, individuals were entitled to a federal welfare payment under federally prescribed rules. TANF affords Governors the flexibility, within certain federal guidelines, to make decisions about how to run welfare programs in their states and how to distribute assistance to individuals.

Health Care—With the passage of the State Children's Health Insurance Program (S-CHIP) in the Balanced Budget Act of 1997, Congress recognized that the best way to improve health care access and outcomes for children is to empower states. Rather than simply allowing states to expand Medicaid with an enhanced federal match, Congress gave them considerable flexibility to design programs that more closely match private insurance plans, but still meet the goals of improving access and outcomes.

States have always been laboratories of democracy, especially in health care. A potential benefit of S-CHIP is national recognition that devolving responsibility for health care to states can improve health care access and outcomes more effectively than a one-size-fits-all federal approach.

Education—Another small step toward devolving authority and flexibility came on April 29, 1999, when the President signed the conference agreement on the Education Flexibility Partnership Act of 1999 to expand the Education Flexibility Demonstration (Ed-Flex) to all states. The new statute allows the U.S. Secretary of Education to waive certain federal statutory or regulatory requirements in exchange for states waiving comparable state regulations. States that are in compliance with Title I and have a comprehensive school improvement plan that has been approved by the secretary may apply for Ed-Flex. The De-

partment of Education has released draft guidance on the expanded program, and several states are developing applications to become Ed-Flex states.

But despite these successes and despite the President's often-stated commitment to federalism, some in Washington still insist on concentrating power here in the Beltway. This tendency to micromanage from Washington is not healthy for democracy, for it separates people from their government.

Preemption of state regulatory authority and restrictions on state revenue sources is becoming a very serious intrusion into state sovereignty. Some prime examples include:

The Estate Tax. The provision in the recent tax bill that phases out the 100 percent state credit for the estate tax was very onerous. It will cost the states upwards of \$75 billion over ten years. Other examples of federal intrusion into state tax activity include the Internet Tax Freedom Act as well as other bills that are circulating that would restrict state corporate profits. Since Congress has respected state tax authority for over 225 years, these are serious federalism issues.

International Trade. The federal government has adopted comprehensive trade measures that preempt numerous state laws. The North American Free Trade Agreement (NAFTA) and General Agreement on Tariffs and Trade (GATT) are major initiatives that Governors supported. Yet, to accommodate the needs and desires of international trade partners who would rather deal with one uniform policy governing trade than fifty different state laws, NAFTA and GATT supersede many state laws. These agreements downgrade the status of state laws from actions that derive from constitutionally determined powers to trade barriers that international agreements can obviate.

Financial Services. The National Securities Markets Improvements Act of 1996 preempted state authority to license nationally traded securities, mutual funds, and large investment advisers. Despite preserving state ability to collect licensing fees, we lost our traditional power to regulate many aspects of securities activities within our boundaries. The Securities Litigation Uniform Standards Act of 1998 has similar adverse implications of states' rights. In addition to prohibiting class action suits based on the violation of state laws, the act permits viable class action suits to be moved from state courts to federal district courts.

Food Inspections. The Food Quality Protection Act of 1995 preempted state regulation of pesticides in the shipping, handling, and production of food.

Telecommunications. The Telecommunications Act of 1996 overhauled the regulation of local telecommunications services. The act ostensibly sought to deregulate the local telephone industry, but it effectively re-regulated the industry by stripping state and local regulators of their traditional authority over local telephone service and transferring this power to the Federal Communications Commission (FCC). Consequently, the federal legislation eliminated or seriously impaired states' ability to control the range, quality, and affordability of telecommunications services available to their citizens.

In addition, the patients' bill of rights and energy legislation include significant preemption concerns. Moreover, the education bill now in conference—which features many provisions that Governors support—cuts Governors out of the process of writing state education plans. This is classic one-size-fits-all Washington micro-management at its worst.

I raise this concern because the issue of creating a streamlined sales tax system for the 21st century gives Congress the chance to do right by our states. When dozens of states can work together to solve a problem, Congress should recognize that effort and help make the solution a reality.

Governors understand, as you do, that the Internet is an incredibly powerful tool. It provides a new nexus between customers and businesses, between citizens and their government, and between people. Access to this new public square must continue to be open and unhindered.

What the Internet should not be is a way for buyers and sellers of goods and services to avoid their obligation to pay sales or use tax. That's why America's Governors urge Congress to enact legislation giving states the authority to require remote sellers to collect and remit sales and use taxes.

We know that the current sales and use tax collections systems must be dramatically simplified for this proposal to work. Indeed, 13 states have already adopted model legislation to simplify their systems and reduce the complexity and cost of collection.

The simplifications, as recommended by the Streamlined Project include:

- centralized, one-stop multi-state registration;
- uniform definitions for goods and services;
- uniform rules for attributing transactions to particular taxing jurisdictions;
- uniform and simplified rules for dealing with exempt transactions;
- procedures for relieving sellers from liability to the state for errors resulting from use of information provided by states;
- certification of software that sellers may use to determine tax due on transactions;
- uniform rules for claiming bad debts;
- uniform formats for returns and remittances, including electronic filing and remittances;
- state-level administration of all state and local sales and use taxes; and,
- uniform audit procedures, including the option for a single, multi-state audit.

In Michigan, such legislation has already passed the State Senate and is being considered by the House, and I expect to sign it later this year. When an appropriate number of states do agree to a common approach through an interstate compact, we desire Congress to grant states the authority to impose the duty to collect on remote vendors.

What we are proposing is a partnership between the states and the federal government that achieves our goals of fairness and simplicity. When states adopt a streamlined and technologically efficient tax system for the 21st century, the federal government will require remote sellers to collect current sales tax obligations. The Governors would favor a sales threshold below which remote sellers could not be required to collect use taxes, otherwise known as the *de minimis* provision.

The Governors recommend that Congress use any extension of the Internet Tax Freedom Act as an important opportunity to enact legislation establishing a procedure that would encourage states and localities to continue their initiative to develop and implement a simplified and streamlined sales tax system.

I should note that America's Governors support the simplifications contained in H.R. 1410, introduced by Representatives Istook and Delahunt, to reduce the burden of state and local sales tax compliance and to save the nation's economy millions of dollars by bringing our tax system into the 21st century.

The simplifications in the bill are consistent with many of the efforts now being undertaken by the Streamlined Sales Tax Project, including the model statute as well as the accompanying agreement states would enact to implement a much simpler multi-state sales tax system.

Mr. Chairman—four out of every five states are willing to simplify their systems and dramatically reduce the complexity and cost of collection for all sellers. I believe that shows our commitment to adapt to the new economy and to grow with the Internet.

Let me be very clear on one point. I am not talking about a new tax, a tax increase, or a tax on the Internet. Every state that levies sales taxes requires a use tax to be paid if a customer's purchase is made online or out of state. Under current legal standards, a state may only impose sales and use tax *collection* requirements on sellers with a physical presence, or nexus, in the state whether the transaction is over the Internet or not. As a result, remote sellers are able to exploit the market in that state—whether by mail, telephone, or the Internet—without being required to collect or remit tax on their sales into the state. Sellers that are physically present in the state are required to collect and remit the tax.

Obviously, not collecting the use tax on electronic transactions is an incentive for merchants to use electronic or Internet transactions. As e-tailing—versus retailing—continues to grow in popularity, the imbalance and the unfairness to Main Street retailers will continue to grow.

It won't be too long, however, before sophisticated Main Street retailers respond. Consider this example, a customer walks in a downtown department store, picks out a pair of jeans and instead of paying for them at the counter, proceeds to an in-store Internet kiosk. The customer pays over the Internet, a clerk puts the jeans in a bag, and the customer walks out without paying sales tax.

America's major e-tailers are already partnering with major retailers. The tax-savings for their customers is but one of the many advantages of such partnerships. These strategic unions of e-tail and retail will become commonplace.

The bottom line is that eventually the sales and use tax will be rendered obsolete and inefficient as a source of revenue for state and local governments, especially for public schools. Of course, retailers who continue to collect the tax—and continue to

support the United Way and other local charities—will also be rendered obsolete, devastating the backbone of Main Street America.

Consider another example. A business traveler wants to buy an airline ticket from Washington D.C. to Detroit. Instead of calling a travel agent, the traveler simply goes online and buys an e-ticket—which, as Northwest Airlines reports, 65 percent of their passengers use. This committee is well aware that every single passenger who boarded a plane in the United States paid the airline ticket tax. How they paid for their tickets—online or in line from an agent—made no difference.

I should note that federal excise tax on cigarettes, tires, and liquor are collected on Internet purchases as well. I ask this committee: What's different about a pair of jeans, a sofa, or a computer?

Finally, I must advise the committee that while the National Governors Association does not have a policy on extending the moratorium, there is a concern that the current definition of access is extremely broad.

As this new industry matures and expands, firms will bundle significant amounts of content into one fee, which includes access. Furthermore, telephone calls over the Internet, i.e., telephony, are increasing dramatically. These are both issues of tax fairness since the first principle of tax policy holds that similar goods should be taxed in a similar way regardless of how they are delivered.

Telephone calls, on average, face federal, state, and local telephone taxes in excess of 15 percent. To make some telephone calls taxable and others non-taxable is discriminatory. A similar question is raised regarding content delivered via the Internet. A movie, for example, seen in a local movie theater could be taxed, but one downloaded over the Internet would be exempt. Again, this is inequitable. We would ask that the committee look again at the definition of access in light of these two emerging issues.

Thank you, Mr. Chairman, I would be happy to answer your questions and the questions of the committee.

Mr. BARR. Thank you very much, Governor Engler.

Mr. Comfort, we look forward to your perspective from Amazon.com.

STATEMENT OF ROBERT D. COMFORT, ESQ., VICE PRESIDENT, TAX AND TAX POLICY AT AMAZON.COM, AND MEMBER OF THE INFORMATION TECHNOLOGY ASSOCIATION OF AMERICA

Mr. COMFORT. Thank you, Chairman Barr, Mr. Conyers, Mr. Watt, Vice Chairman Flake.

I am Amazon.com's vice president of tax and tax policy, and Amazon is grateful for this opportunity to address the issue of Internet taxation.

Amazon.com is the world's leading Internet retailer, with over 30 million customers in 160 countries.

As a proponent of widespread, low-cost access to the Internet and to the opportunities it opens up to Americans and to the American economy, Amazon.com fully supports congressional action to extend the Internet Tax Freedom Act's moratorium on Internet taxes—Internet access taxes, excuse me—and multiple or discriminatory taxes on electronic commerce.

Without an extension of the current moratorium or action to make the moratorium permanent, States will be free to impose economic burdens on American Internet users, including those least able to pay. Extending the moratorium for a few years would be helpful; a permanent ban would be preferable.

It is also very important, in order to ensure that the benefits of the present moratorium endure with an extension or with a permanent ban, that no substantive modifications be made to the carefully crafted formulations of the original Internet Tax Freedom Act. Seemingly minor changes to the definitions of discriminatory tax or

multiple tax, for example, could have profound effects on the continued efficacy of the moratorium.

In sum, Mr. Chairman, Amazon.com believes that Congress should extend or make permanent the current ITFA moratorium and reject any effort to modify the original act's substantive provisions.

Although not directly related to the moratorium, it has been suggested that Congress should simultaneously define the circumstances in which States could require all remote sellers to collect sales taxes, without imposing an unconstitutional burden upon interstate commerce.

It's widely agreed that this would require the States to simplify their sales and use tax regimes and to achieve some degree of uniformity from State to State. If substantial simplification and uniformity were not achieved, any imposition of a collection obligation, in the absence of judicially defined nexus, would continue to impose an unconstitutional burden upon remote sellers, as described in the Supreme Court's decisions in *National Bellas Hess* and in *Quill*.

Consequently, Mr. Chairman, Amazon.com urges Congress, should it decide to address the sales tax collection issue, to establish clearly defined goals for the States to achieve and to scrutinize with care the results of their efforts, in order to assure Congress and the American people of adherence to the strictures of the Commerce Clause.

Amazon.com could support any properly focused effort among the States to bring their sales tax systems into conformity with the Constitution, as applicable to remote sellers. We are quite concerned, however, that over the life of, for example, the Streamlined Sales Tax Project, most of the politically difficult decisions required to achieve substantial simplification and uniformity have either been deferred or removed from consideration.

Given this history, Amazon.com strongly believes that Congress must not authorize States to require remote sellers to collect sales tax, based solely upon representations that the States will address, somewhere down the road, a variety of criteria for simplification.

Instead, in the event that Congress takes this issue up, it should provide the States with specific guidance about the criteria that Congress deems necessary for constitutionally acceptable simplification of the current sales tax system. The States should be free to decide whether or not they wish to make these changes to their sales tax systems, in exchange for subsequent congressional approval.

This process would respect State sovereignty while providing motivation and a clear road map for simplification, and it would allow Congress to conduct a followup review to ensure that the States have, indeed, genuinely simplified their sales and use tax systems, in order to eliminate the unconstitutional burden on interstate commerce.

I cannot emphasize this last point too strongly, Mr. Chairman. The States have repeatedly demonstrated an inability or an unwillingness to grapple with the issues that must be resolved in order to achieve genuine simplification. The Streamlined Sales Tax Project is only the most recent example.

If the States are free to leave uniformity, sourcing, definitions, vendor compensation issues, among others, for future consideration, while proclaiming that their systems have been streamlined, they will do just that.

Congress must review their actions at the end of the simplification process, not approve them in advance. Otherwise, Amazon.com and all other remote sellers would lose their Commerce Clause protections, even though the unreasonable burdens imposed upon our businesses by the crazy quilt of sales and use tax regimes would remain.

Congress must also provide a mechanism to ensure that the States that are permitted to require remote sellers to collect sales tax will continue to comply with the congressionally mandated, constitutionally required criteria for simplification and uniformity. If, in the future, a State chooses to diverge from these criteria, then the constitutional limitations set forth in *National Bellas Hess* and in *Quill* must once again apply to that State.

Amazon.com believes that, at a minimum, States and localities must meet and maintain the following requirements for simplification and uniformity:

Sales tax rates applicable to remote sales must be determinable based solely on the geographic area information included in a customer's address. Thus, although a single, nationwide rate applicable to remote sales would be the simplest approach, Amazon.com does not believe it would be necessary. One rate per State could work very well. Five digit zip codes would be the smallest acceptable sales tax jurisdiction, because consumers don't know and remote sellers have no way of determining any smaller or different tax rate areas.

Uniform definitions and rules must define what is includable in the sales tax base and must provide specific rules regarding the allocation of shipping and handling charges, coupons, discounts, and other charges to orders that contain both taxable and nontaxable goods.

Uniform definitions and sourcing rules must be developed for the sale of digital goods.

States must provide reasonable compensation to remote sellers for collecting sales tax.

And lastly, State and local governments should be required to assist remote sellers in educating consumers on this issue.

Mr. Chairman, Amazon.com appreciates your invitation to provide its views on this important public policy matter and would welcome the opportunity to elaborate further.

[The prepared statement of Mr. Comfort follows:]

PREPARED STATEMENT OF ROBERT D. COMFORT

Chairman Barr, Mr. Watt, and members of the Subcommittee, my name is Robert Comfort. I am Amazon.com's Vice President for Tax and Tax Policy. A pioneer in electronic commerce, Amazon.com opened its virtual doors in July 1995 with a mission to use the Internet to transform book buying into the easiest and most enjoyable shopping experience possible. Today, Amazon.com also offers consumer electronics, toys, CDs, videos, DVDs, kitchenware, tools, and much more. Well over 30 million customers in more than 160 countries have made us the Internet's number one retailer.

Amazon.com is grateful for this opportunity to address the issue of Internet taxation. As a proponent of widespread, low-cost access to the Internet and the oppor-

tunities it offers Americans and the American economy, Amazon.com fully supports Congressional action to extend the Internet Tax Freedom Act's moratorium on Internet access taxes and multiple or discriminatory taxes on electronic commerce. Without an extension of the current moratorium, or a move to make the moratorium permanent, states will be free to encumber American Internet users, including those least able to pay. Extending the moratorium for a few years would be helpful, but a permanent ban would be preferable.

It also is very important, in order to ensure that the benefits of the present moratorium endure with an extension or permanent ban, that no substantive modifications be made to the carefully crafted formulations of the original Internet Tax Freedom Act. Seemingly minor changes to the definitions of "discriminatory tax" or "multiple tax," for example, could have profound effects on the continued efficacy of the moratorium.

In sum, Mr. Chairman, Amazon.com believes that Congress should extend or make permanent the current ITFA moratorium and reject any effort to modify the original Act's substantive provisions.

Although not directly related to the moratorium, it has been suggested that Congress should simultaneously define the circumstances in which States could require all remote sellers to collect sales taxes, without imposing an unconstitutional burden upon interstate commerce. It is widely agreed that this would require the States to simplify their sales and use tax regimes and to achieve some degree of uniformity from State to State. If substantial simplification and uniformity were not achieved, any imposition of a collection obligation in the absence of judicially defined "nexus" would continue to impose an unconstitutional burden upon remote sellers, as described in the Supreme Court's decisions in *National Bellas Hess* and *Quill*.

Consequently, Mr. Chairman, Amazon.com urges Congress, should it decide to address the sales tax collection issue, to establish clearly defined goals for the States to achieve, and to scrutinize with care the results of their efforts, in order to assure Congress and the American people of adherence to the strictures of the Commerce Clause.

Amazon.com would support any properly focused effort among the States to bring their sales tax systems into conformity with the Constitution as applicable to remote sellers. Amazon.com is quite concerned, however, that over the life of the Streamlined Sales Tax Project, most of the politically difficult decisions required to achieve substantial simplification and uniformity have either been deferred or completely removed from consideration. Given this history, Amazon.com strongly believes that Congress must not authorize States to require all remote sellers to collect sales tax based solely upon representations that the States will address, somewhere down the road, a variety of criteria for simplification.

Instead, Congress should provide the States with specific guidance about the criteria that Congress deems necessary for constitutionally acceptable simplification of the current sales tax system. The States should be free to decide whether or not they wish to make these changes to their sales tax systems, in exchange for subsequent Congressional approval. This process would respect state sovereignty while providing motivation and a clear roadmap for simplification. And it would allow Congress to conduct a follow-up review to ensure that the states have indeed genuinely simplified their sales and use tax systems in order to eliminate the unconstitutional burden on interstate commerce.

I cannot emphasize this point too strongly, Mr. Chairman. The states have repeatedly demonstrated inability or unwillingness to grapple with the issues that must be resolved in order to achieve genuine simplification. The Streamlined Sales Tax Project is only the most recent example. If the states are free to leave uniformity, sourcing, and compensation issues for "future consideration," while proclaiming that their systems have been streamlined, they will do just that. Congress must review their actions at the end of the simplification process, not approve them in advance. Otherwise, Amazon.com and all other remote sellers would lose our Commerce Clause protections, even though the unreasonable burdens imposed upon our businesses by the crazy-quilt sales and use tax regimes would remain.

Congress must also provide a mechanism to ensure that States that are permitted to require all remote sellers to collect sales tax will continue to comply with the Congressionally mandated, constitutionally required criteria for simplification and uniformity. If, in the future, a State chooses to diverge from these criteria, then the constitutional limitations set forth in *National Bellas Hess* and *Quill* must once again apply to that State.

Amazon.com believes that, at a minimum, States and localities must meet and maintain the following requirements for simplification and uniformity:

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Uniform definitions and rules must define what is includable in the sales tax base, and provide specific rules regarding the allocation of shipping and handling charges, coupons, discounts, and other charges to orders that contain both taxable and nontaxable goods. Uniform rules also must cover the refund of sales taxes in the case of customer returns where the seller retains shipping charges.

Uniform definitions and sourcing rules must be developed for the sale of digital goods, such as downloaded music and software.

States must provide reasonable compensation to remote sellers for collecting sales tax. At a minimum, such compensation must encompass the cost incurred by remote sellers for credit card processing fees assessed as a percentage of the total amount of both the price of the item sold and the applicable sales tax.

Lastly, State and local governments should be required to assist remote sellers in educating consumers on this issue by, for example, establishing a toll free phone number, an Internet web site, and a direct mailing effort.

Mr. Chairman, Amazon.com appreciates your invitation to provide its views on this important public policy matter and would welcome the opportunity to elaborate further on these comments.

Mr. BARR. Thank you very much, Mr. Comfort.

The Chair would like to recognize the presence of some additional Members of the Subcommittee and the full Judiciary Committee.

The Chair is pleased to recognize Mr. Weiner of New York's presence and welcome him to the Subcommittee hearing.

I believe Ms. Waters from California was with us also, and we welcome her presence today also.

I'm pleased to recognize Mr. Steve Chabot, the gentleman from Ohio, a Member of the Subcommittee. Appreciate his presence today.

And also we extend a warm Subcommittee welcome to Mr. Spencer Bachus, the gentleman from Alabama, a Member of the full Judiciary Committee, and thank him for joining us today.

We'll now proceed to questions for the witnesses. We will adhere strictly to the 52Dminute rule, in deference to the responsibilities that each one of the four witnesses has for running their State, running their commonwealth, running their congressional district, and running a very large corporation.

And we would appreciate the witnesses trying to limit their responses, as much as possible, so we can cover as much ground, within the parameters of that 52Dminute rule, as possible.

And if there is additional material, either questions from Members of the Subcommittee or additional answer or background material that the witnesses would like to submit that they were not able to cover today, we certainly welcome that being submitted for the record, following the hearing today.

If I could, Mr. Cox, begin with you. Your two pieces of legislation that bring us here today do not get into the broader question of tax simplification.

Is there a particular tactical or strategic or principal reason why your bills are more narrowly focused? And why do you think it's important to proceed on that basis?

Mr. COX. Chiefly, Mr. Chairman, because time is of the essence.

As you recall, last Congress, in the 106th Congress, this Committee and the full House of Representatives voted overwhelmingly to extend the moratorium, but there was a deadlock in the Senate Commerce Committee. And as a result, no legislation was transmitted to the president. As a result, we are running short of time.

Everyone is agreed, as the Ranking Member of the full Committee, Mr. Conyers, pointed out, that we should not countenance multiple or discriminatory taxes upon the Internet. The questions of sales tax simplification, which are also important questions, are at once intellectually severable from this question and much less tractable. And we may not get that accomplished in time.

And so, I'm very, very concerned about the consequence of going beyond October 21 without a law on the books.

Mr. BARR. Thank you.

Governor Gilmore, in your opinion, should Congress facilitate State and local efforts to collect taxes on Internet commerce?

Governor GILMORE. Mr. Chairman, I don't think that it's essential to the moving ahead of these resolutions. These resolutions can go forward and deal with some of the essential issues without concerning ourselves with the issue of simplification at this time, and I'll tell you why.

It would be unwise, I think, for the Committee to recommend to Congress that they buy a simplification program sort of like a pig in a poke. We don't really know yet what type of simplification program is really going to come forward.

So to hold up the moratorium, waiting for a simplification proposal, is probably not in the best interests of the people of the country.

We've thought about the simplification efforts they've been going through, and there are very great difficulties to try to overcome. And I know that many projects of the States are trying to overcome them. But a lot of States and legislatures are just not going to want to cede their authority for making tax policy to a multistate compact.

Some of the localities have the ability to tax on their own, and it would require constitutional amendments in those States to even make them eligible to be participating in a compact. A State court might then interpret any type of rules in different ways.

There are hidden tax increases that would occur because there would be varying local rates in order to conform to a compact. For example, in Wisconsin, when a person buys a \$20,000 car and takes a trade for a car worth \$5,000, he pays tax on \$15,000. But the NGA model act would very likely make that transaction to be on \$20,000, so it would be an increase of taxes, ultimately, on the citizen, by the conforming with such a program.

In North Carolina, a manufacturer who pays \$100,000 for a machine pays a 1 percent sales tax, but it's capped at \$80. But under the NGA model, there are no caps, so that would mean a tax increase on the people of North Carolina, if they had to do that.

These are troublesome issues that I think that have yet to be come to grips with at this time.

Privacy issues are of great concern. The question of defining what's a product and what's a service in all of the Uniform Act are very difficult. And right now, there are many conflicts between the State legislative bodies and the NGA proposal.

So, in short, there are a lot of problems that still have to be resolved. I think it's going to take a long time. And maybe they may never be resolved.

And under those circumstances, it would really be better to go ahead and move ahead with Congressman Cox's proposal, as opposed to holding it up for a simplification program that the Congress doesn't know what they're buying yet.

Mr. BARR. Thank you, Governor.

Governor ENGLER, given the recent—and, I think, clearly demonstrable—weakness in the technology sector, isn't it important to extend the moratorium, if we are not able to, in a timely fashion, tackle the broader and very legitimate questions that you've raised regarding tax simplification?

Governor ENGLER. Mr. Chairman, I'm not certain of all the reasons. There are weaknesses in the technology sector. But it isn't particularly related to use tax collection challenges that the States face. The proposal would gain significantly in productivity. We've made some real progress.

But as I look at it, it's sales of systems. It's business purchases that are the issue. It isn't the soaring companies selling goods and—goods over the Internet that's the issue.

And I think that the issue is at hand for us. We saw the Congress move with great speed to wipe almost \$75 billion of State estate taxes over the coming years, breaking a 275-year partnership on that part of federalism. And we were surprised at that. And I think this is an opportunity for, you know, Congress to do something that would recommit itself to the partnership with the States.

Mr. BARR. Thank you.

The Chair recognizes the distinguished gentleman from North Carolina, Mr. Watt, for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman. There doesn't seem to be any or hardly any controversy about the access tax, so I guess there's no real reason to be asking about that.

So I have only two questions, one for Representative Cox and Governor Gilmore, and one for Governor Engler and Mr. Comfort.

Representative Cox and Governor Gilmore, I take it that you, the two of you, don't have any real problems with what Governor Engler and Mr. Comfort have said about simplification and the need to have something done to have a regimen in place once simplification occurs, even with regard to sales over the Internet? Right or wrong?

Mr. COX. For my part, I certainly have no problem with undertaking an examination of those questions and hopefully answering them to everyone's satisfaction.

I will say that, as a veteran of this effort, working very closely with, for example, the National Governors Association prior to the

enactment of the Internet Tax Freedom Act, that it's a big country, and not only are State tax issues involved, but also local tax issues.

Mr. WATT. But the concept of taxing sales that occur on the Internet, you're not—I mean, there's a lot of confusion out in the public about what the moratorium was all about. I just want to be clear that there is no opposition to the concept of taxation on an equal footing with mainstream businesses. Retailers and e-tailers ought to be paying—purchases from e-tailers and retailers ought to be taxed on the same basis.

Mr. COX. Indeed, the name of the legislation that I've introduced is the Internet Nondiscrimination Act. The purpose is to make sure that there is not discrimination on the Internet——

Mr. WATT. Got it. Okay.

Mr. COX [continuing]. So that we're collecting taxes on electronic commerce that we're not collecting with any offline analog.

So my only concern, as I mentioned, is that because these problems are so complicated, and we only have a few months, if we hold one hostage to the other, we——

Mr. WATT. I got that.

Mr. COX. I appreciate it.

Mr. WATT. I heard that.

Governor Gilmore—and I wasn't cutting you off, I just——

Mr. COX. I appreciate it.

Mr. WATT [continuing]. I think we're all together. And I just wanted to be clear so I can get on to the second question.

Governor Gilmore, are you with us on that aspect? I mean, this is not a trick question. I'm just trying to get a——

Governor GILMORE. I want to make sure I understand the question. You mean the question of whether or not that there ought to be, by definition, a tax on e-commerce over the Internet?

Mr. WATT. No, whether there ought to be equivalent taxes on retail and e-tail purchases.

Governor GILMORE. Well, you know, I've always taken the position that there ought not to be taxation on the Internet because it's—on e-commerce over the Internet, because it's in the best interests of working men and women to have another opportunity to do commerce.

Mr. WATT. So you think that industry ought to be exempt from any taxation then, even on purchases over the Internet?

Governor GILMORE. No, well, the point is that it's not a level playing field anyway. The whole issue that we're dealing with, I think, is the question of whether or not there are burdens that are going to be equal between storefronts and e-commerce.

Mr. WATT. That's the question I'm asking, Governor.

Governor GILMORE. Yes, it is.

Mr. WATT. I'm not asking any trick question here. That's the question I'm asking.

Governor GILMORE. I know, and——

Mr. WATT. Should the burden be the same?

Governor GILMORE. Well, and it's useful to recognize that the burdens are not the same now. And——

Mr. WATT. That's not the question I'm asking.

I'm asking, should there be the same taxation on retailers and e-tailers? That's all I'm—I didn't think this was all that complicated.

Governor GILMORE. Yes, and I think it is—that the report that we have issued indicates that it is not inevitable that you should go to taxation on commerce over the Internet. Simplification has its own value, in and of itself.

But we make decisions, as a matter of policy, all the time, Mr. Watt, to do—

Mr. WATT. Mr. Chairman, I think I give up. I'm not—obviously, I'm not going to get to the second question I wanted to ask, which was how we were—what progress we were making toward getting to some simplification. But—well, the red light's on, I thought.

Mr. BARR. The gentleman has 10 seconds remaining of the 5 minutes.

Mr. WATT. Well, let me ask that question. Are we making any progress toward a simplification? And what do you all perceive is the timetable of getting to it?

Governor ENGLER. Mr. Watt, I think we are making progress. And let me just use a simple example, this microphone. We probably have 50 States—or the 45 States that levy sales and use taxes—that could agree that this microphone should be subject to a tax. And so, we could then—and I think we've got 85, 90 percent of goods—

Mr. WATT. You mean the sale of the microphone, not the use of it?

Governor ENGLER. The sale of it. Oh, not the first amendment, no. We're not going to go there. No burdens there. [Laughter.]

And we know money isn't even part of that, according to the Supreme Court.

No, but just the microphone, the purchase of. And if you buy it in Virginia, you pay the Virginia sales tax. If you buy it someplace else, you'd pay that State's sales tax. If you buy it in Michigan, you pay 6 percent—one rate across the State.

If you buy it in Ohio and bring it back to Michigan, then you owe Michigan the 6 percent use tax. That obligation is there, whether if you go to Ohio and carry it back, buy it over the Internet, or order it from a catalog.

Some companies are kind enough to help you meet the obligation; they'd collect the tax and remit it to the State and then you're done with it. If they don't do that, then you've got to remember, if you buy it in, you know, June on this date, you've got to remember next year when I'm doing my taxes that I've got to add that 6 percent of this cost of this microphone to my State tax return.

Mr. WATT. Mr. Chairman, I think if I had to do this over again, I'd start with the nonpolitician and get the answer and work the other way, rather than starting with the politicians and working down to— [Laughter.]

I'm sorry. I yield back.

Mr. BARR. Thank you.

The Chair recognizes the Vice Chairman of the Subcommittee, the gentleman from Arizona, Mr. Flake, for 5 minutes.

Mr. FLAKE. I thank the panelists. It's been enlightening for me.

Representative Cox, have we learned anything from catalog sales? Is that instructive in any way? Can you briefly comment on that?

I see Governor Engler nodding his head, if you want to comment after that.

Mr. COX. Indeed, it's for this Committee, and I think for everyone in Congress, a useful exercise to try and wash away from our analysis anything that has to do with electrons or the Internet or new technology because the legal issues that we're wrestling with are not that new. The legal issues presented by catalog sales, which have been with us throughout the 20th century, are essentially the same.

And it is, as a result, a catalog sales case, or a couple of them, that we're dealing with—the Supreme Court's decision in *Quill*, for example—that govern our actions here.

Second, I would observe that, even now in the 21st century with the explosion in use of the Internet, catalog sales dwarf Internet sales. And that looks like it will be true for a long time.

And so again, the legal question and the policy question that we have, with respect to the taxation of remote sales, is one that we can answer independent of the technology of the Internet.

So in both of those respects, I think we can infer that the fact that we haven't yet solved this question does not bode well for pulling the drawstrings together and getting all the loose ends taken care of between now and 117 days from now, particularly when we have to go through this Committee, maybe other Committees that also have referral on the legislation, then the floor in the House. We've got to do the same thing over in the Senate. Then we've got to appoint conferees, and we've got to work that out, go back to the floor of the House and the Senate, get the White House involved and so on.

I just think that the risk of having this moratorium expire is enormous if we load on to it these other admittedly very important issues.

Mr. FLAKE. Governor Engler?

Governor ENGLER. The first lesson we've learned from catalog sales is we should have dealt with this issue when it was smaller, because then the numbers wouldn't be so big, and I think some Members of Congress wouldn't be as apprehensive.

But I think the one thing that we've learned, since the catalog debate began many years ago, is that there is no movement in Congress to ban use tax collection. There is no effort to do away with use taxes.

Absent that—and of course, any State could drop their use tax; that's the tax we collect on the remote sales. We have not done that. Forty-five States maintain those use tax systems.

So we then have the challenge—and I think we're here at a different era, saying, "Look, let us work together. We think we can reach agreement on product after product after product all over the country."

And interestingly enough, business is a great complier with the tax. Businesses collect the use tax. I mean, give the business community their due on this. This is really largely individual transactions that we're dealing with.

On a car, for example, you've got to title a car, so you find out if the tax has been paid on that or not, so that's not an issue either. But it is an issue if it is this microphone or the table at which we're sitting.

So that's where we're headed. And the one point I would stress that I think has been confused in the American public is that, with the moratorium—and I appreciate Congressman Cox's clarity on this today—the moratorium dealt only with taxes on access to the Internet. The moratorium had nothing to do with the tax collection on goods that are purchased over the Internet or through a catalog—did not deal with that. They are not subject to any kind of moratorium at all.

Mr. FLAKE. Governor Gilmore?

Governor GILMORE. And therefore, Congressman Flake, there is no reason not to proceed with these resolutions. They should move ahead. They deal with the access issue only. It's something that's clean. It can be taken care of. And we can leave to another day some very complex issues, like the one that you've raised.

One thing we've learned from observing Internet sales, which are very similar to catalog sales, is it doesn't make much difference. Even today, after all these years, the Internet sales are less than 1 percent of all sales taxes nationwide.

Every State, as Governor Engler has pointed out, has the absolute ability to put together a use tax. And they should be spending their time dealing with how to collect use taxes within their own States, as opposed to, you know, trying to figure some convoluted way to make foreign people in other States try to resolve those issues.

And the fact is that the law says that you can't require the remote seller to serve as a collection agent for the State unless the burdens are equal with people within a State. And that's a very difficult thing to try to achieve, though I know many people are trying to find a simplification process.

As I pointed out earlier, it's very difficult to achieve and may not be achievable.

Mr. FLAKE. In the few seconds I have left, Governor Engler, it's unclear from the statement whether you oppose the extension of the moratorium, absent any resolution on the streamlining.

Governor ENGLER. Pretty much a nonevent. I don't really care because no State is seeking to levy new taxes on access to the Internet.

You've got 10 States that are grandfathered; there would be an issue in those States. I think on the Committee we have a couple of Members that come from those States. Wisconsin and Ohio, I guess, are the two that come to mind here.

But even in the proposal, I believe, the congressman has put forward, we're not seeking to undo the grandfathering. So it's a non-event.

We can get a bill passed. We can have a bill signing. In the scheme of things, it doesn't matter much.

What we're having a discussion about, though, is vitally important, because it goes to the heart of federalism and the ability of the States to survive.

Mr. FLAKE. Thank you.

Mr. BARR. I thank the gentleman.

The Chair is pleased to recognize the gentleman from New York, Mr. Weiner, for 5 minutes.

Mr. WEINER. Thank you, Mr. Chairman.

Mr. Comfort, so far I think that Governor Gilmore is the only person that disputes the equity that seems to not be in the system in Governor Engler's example of the person shopping for a pair of jeans, going to a kiosk and buying it on the Internet.

Do you share the long-term view that, at the end of the day, getting back to Mr. Watt's attempt at a question, do you dispute that, at the end of the day, it's fair for me to purchase a book at my local bookstore, purchase a book via Amazon.com, and be responsible for the same tax burden, and for the two sellers to be responsible to collect or to help the State collect that tax in a similar way? Do you see—does Amazon see that as the long-term direction that we should probably be going with this issue?

Mr. COMFORT. To have the tax burden the same, regardless of the mode of purchase?

Mr. WEINER. Yes.

Mr. COMFORT. Amazon.com finds it very difficult, as matter of abstract principle, to argue against that position.

Our concern is that yes, we have an unlevel playing field right now. But it should be borne in mind that it's unlevel in both directions. Both sides are forced to run uphill toward the 50-yard line.

Main Street retailers are concerned that taxes aren't being collected on e-commerce transactions. And they regard that as the unlevel playing field.

Remote sellers, however, face this welter of 7,600 jurisdictions with wildly conflicting rules about what's taxable, what's not taxable, tax holidays, and so on. And therefore, we're running uphill toward the 50-yard line, in the event that we be asked to collect.

If that system can genuinely be simplified and streamlined—and we have, in our testimony, outlined sort of basic headings for that simplification—then we believe it would not be unfair.

Mr. WEINER. Well, Mr. Comfort, I happen to believe that the compliance issue of this and the technological burdens faced are wildly overstated.

I think if Congress were to pass a bill tomorrow requiring you to collect it, you will have five vendors on your doorstep the day after with software that they'd already written to allow you to do it just by entering the five-digit zip code. I really find it hard to believe.

Given the technological abilities that people have and the public nature of this data, it's something that just needs to be mined and put into a program. So I, frankly, think that that element to this has been exaggerated.

Governor Gilmore, you now stand in contrast, so let me give you an opportunity. On the equity of that transaction that Governor Engler used in his example and that has been used in other ways before, make the argument—putting aside being the governor of the State that perhaps represents AOL or something—but just as a sheer matter of equity and from the perspective of the consumer making a decision, theoretically based on where he's going to get the service he wants and the product he wants, make me the eq-

uity argument that he should pay, that that consumer should have less of a burden in one mode of shopping, and that the person selling it to them should have different responsibility under the law to help collect it.

Governor GILMORE. Congressman, we must remember that it is the people or the individuals who are paying the taxes, not the businesses. There is a tendency to confuse these issues and suggest that the duty of the Congress is to be fair to the different businesses in different places and have equity. What we're really focusing on here is the imposition of taxes on people who are paying it by going through a different type of vehicle.

But the key points are the following: that things are different; that we do preferences, as a matter of public policy, all the time.

Yesterday, in Virginia, I announced four enterprise zones in particular areas because we had a public policy that said that there ought to be a preference in particular areas.

We see advantages, for example, just in retail, all the time. Traditional retail has a dramatic advantage over Internet retail because they can offer a product that can be seen, touched, felt, smelled, taken home right away. And if there's a problem with a return, it can be done on the very same day. E-commerce does not offer that same convenience and never will be able to.

And then, of course, there's the issue that Mr. Comfort raised, which is the cost of compliance. The fact of the matter is that if you tried to put a burden on a seller that he has to collect for many States, whereas a Main Street retailer has to collect only for the State that he's in, it's inherently inequitable.

I want to address the kiosk issue because we addressed that in the commission. That is a remarkable example, but I think it's easily dealt with.

I have proposed and put into the report that we issued that you deal with that kiosk example, the jeans up at the kiosk issue, by just simply saying that you're going to make the tax-free zone an interstate sale. But if it's going to be—a person's going to go up to a store, buy a pair of jeans, go to the kiosk, and buy them that way to avoid the tax, you just don't allow that. You just say this is going to an interstate tax-free zone.

Mr. WEINER. In the examples you have given in the inequity, in the different ways that you shop, it doesn't actually address my—my question was not about whether or not we make different decisions based on different modes of shopping. It's why, as a matter of equity, should the tax treatment offer incentives for one activity or another, or disincentives for one activity or another?

That seems to be not a very conservative position. It seems like we should be allowing the marketplace to operate as freely as possible, and that when government starts with its failure to enforce tax policy, or with its tax policy starts to make those decisions in the marketplace, I believe it distorts the marketplace some.

So I'm not talking about whether or not you get good service at the shop. That's how they're going to compete in the marketplace.

Governor GILMORE. Sure.

Mr. WEINER. I'm saying, where should we—on the sidelines, somewhere in the game, completely in the game—I'm wondering, as a matter of equity, and I'm still wrestling with these issues, as

a matter of equity, why it should be that we should have a different tax policy, depending upon a different way you actually make the purchase.

Governor GILMORE. Well, and again, we do all the time. And we do it based upon a variety of policies. And Congressman Cox just reminded me that remote sellers don't use the services within a particular State, whereas retail merchants do use services within the State.

So therein right there lies a different—

Mr. WEINER. But Governor Gilmore, you just critiqued my question by saying I shouldn't refer to the tax collection paid, and I shouldn't compare two businesses, and now you're doing it in your example.

I'm asking, from the perspective of the consumer who is making a decision in the marketplace, he is deciding whether or not he should go to the shop down the street with all its merits, go to the Internet with all its merits. From a perspective of government, why should there be two different tax treatments?

Governor GILMORE. Because it's better for people to be able to shop, if they possibly can, within a system where they don't have to pay the tax.

And then the question then becomes the question of this: Does that distort—is it the job of the Congress to undistort the marketplace in some way?

And I think we instead need to focus on the purchaser and give them an opportunity, in this limited way, to be able to purchase without having to pay the tax, particularly when there are many dozens—well, many policy reasons why you could make those distinctions. And we do, every day, in a variety of cases.

Mr. BARR. The time of the gentleman has expired. Thank you.

The Chair recognizes the gentleman from California, Mr. Issa, for 5 minutes.

Mr. ISSA. Thank you, Mr. Chairman.

Mr. Comfort, there is a district or an area of Colorado in which I believe there are seven different tax possibilities in a single zip code. Who would write software to teach you how to deal with that?

Mr. COMFORT. We've asked that question, Congressman Issa, and no one has, to this point.

I respectfully have to differ with Congressman Weiner. We have been talking to, as far as we know, each of the companies that is attempting to write this kind of software. And there is presently no one, even in conjunction with Amazon.com, which has fairly sophisticated resources in this area, that has been able to produce a system that could deal with the multiple zip code problem, with problems of allocating coupons, discounts, different shipping costs, issues about returns, tax holidays.

The rates aren't so much the problem, for Amazon, at any rate. They would be for some smaller businesses. And those are legitimate concerns the smaller businesses might have.

But the lack of uniformity, the tremendous financial burden that compliance is going to cause, together with a virtual certainty—given the existing lack of uniformity among the 7,600 jurisdictions—a certainty that a seller attempting to comply in the present

system will both over-collect and under-collect in various jurisdictions.

Mr. ISSA. I know the governor would like to—Governor Engler would like to—

Governor ENGLER. I just think that that point on the zip codes is absolutely correct. And I think advocates of getting assistance in collecting of taxes absolutely have to stipulate right up front, one rate per zip code.

It's easy for Michigan. It's one rate for Michigan, period.

But I think if local governments can't work that out with the State government, then you ought to send everybody home and say, just struggle with it, as you've struggled with it.

But I think we deserve the opportunity to try and work it out. And that's what we're asking for. I know it's hard. There's a lot of evidence of that. And it's harder now than when it was just a catalog.

But we deserve an opportunity to try, I think. I think our partnership is worth that much. And let us see.

And maybe we can only work it out on 90 percent of all of the goods. Well, maybe that's the 90 percent, then, that's subject, and the 10 percent is not.

And the other issue that's real is that pair of jeans in our example. There are a couple of States that say that those are work clothes, so therefore, they're tax-exempt, and others don't. We have to work those things out.

But give us a chance, as opposed to not giving us a chance. And I would just again remind everyone that every State today has an opportunity to give their citizens tax repurchases of all goods. Five actually have done that.

And in those States, if they have—more power to them, but those of us who live in States where it hasn't been done shouldn't be here trying to get it done through Congress. That insults federalism, in my judgment.

Mr. ISSA. Governor Gilmore?

Governor GILMORE. Congressman, I think there is nothing wrong with the States making an effort to do this if they want to try to do it. They have been working on it now for several years. And as Governor Engler acknowledges, it's a very difficult task.

And it is not just a matter of software. Software can only be the servant of the system that it's trying to organize and no more. And the reality is that local jurisdictions often have home rule. Everybody has different definitions, as Governor Engler says.

Clothes are one thing in one place and another in another. Maybe you want to have a tax holiday this year for children's clothes, and maybe next year you don't. And that is all going to be adjustable and variable over thousands of different jurisdictions.

So that's the real, fundamental problem.

The other problem is that it's not hardly worth it. It's so little, at this point, in terms of the overall percentage of sales taxes. In the meanwhile, you put a potential burden that they can't—that's hard to overcome, when at the—meanwhile, the industry is creating new jobs and new assets and new resources, which yields more revenue for the States anyway.

Mr. ISSA. My time is running out and just two quick questions.

Mr. Comfort, do you happen to know how much they're asking for these wonderful pieces of software?

Mr. COMFORT. High up into six figures, in most cases. But, Congressman, that actually would not be the biggest burden for a company like Amazon. Our principal burdens would be in a diversion of information technology—existing information technology resources, our software engineers—to deal with it, plus the credit card costs.

Mr. ISSA. Right. I understand that. I guess, as a Member of the Committee on Small Business, you might be able to afford hundreds of thousands of dollars, perhaps millions, but if the software even costs \$10,000, it could be very adverse to a small startup business.

Governor Engler?

Governor ENGLER. Under the streamline project, the anticipation is we largely provide that. I mean, there's so much money.

I mean, I realize, I'm from Michigan, so dollars may be of more value. But just in Florida, \$754 million estimate, this could mean; Texas, \$932 million; \$7.5 billion in California is one of the numbers, you know, in terms of what's foregone, purchases where you didn't collect the use tax.

We'd provide—we'd like to provide that software. It would be a bargain. And we'd pay the retailer, too. We'd pay the local retailer to collect it. There's nothing wrong with paying the remote retailer.

Mr. ISSA. With the indulgence of the Chair, I haven't heard anyone talk about, hypothetically, we do this and tomorrow there's a tax. What happens to the foreign company operating outside our jurisdiction who decides to sell anything to be transmitted through the Internet and/or deliveries via parcel post. Have any of you looked at the complexity of the even playing field, if in fact we simply shift these jobs and their revenues offshore by our tax policy?

Governor ENGLER. We've been trying to understand, in some of the GATT negotiations and other trade agreements that have been negotiated, sort of that question even on existing systems, because there has clearly been some impact that sets up even existing State programs that might be favorably developed in any one of our States for one of our State's primary industries.

And we're finding that some of the international agreements are being negotiated almost without regard to us. And so, that problem exists today on current issues. And it is ripe for another meeting and some work on it, because it's right there, right now.

Mr. ISSA. Thank you.

And thank you, Mr. Chairman. I think they made our point very well on why we need this extension of time to negotiate the kind of compacts that would be workable.

Mr. BARR. Thank you.

The Chair would ask unanimous consent to recognize the gentleman from Alabama for 60 seconds to make a brief statement.

Mr. BACHUS. Thank you.

First, I want to endorse what Governor Engler said, and to say to Representative Cox and to Governor Gilmore: We in Alabama are in proration in education. Classroom material is being cut. Teachers' salaries are being limited. School buildings are not being repaired.

As a practical matter, as all of you on the panel know, sales taxes can't be collected on e-commerce transactions by the State of Alabama or other State and local governments. And until that issue is solved, law enforcement and education in many States are taking a significant hit.

And I want to say to you that, to me, that is a more important issue than the issue of this moratorium.

And I place the State and local governments being able to collect taxes that the people of those States have voted and authorized as an important issue.

And I would say, particularly to Governor Gilmore, I think that's in the best interest of working men and women, that we address that issue, too.

Thank you.

Mr. BARR. Thank you, Mr. Bachus.

The Chair would ask unanimous consent to recognize the gentleman from the Commonwealth of Virginia, Mr. Goodlatte, for 1 minute.

Mr. GOODLATTE. Thank you, Mr. Chairman.

I, I guess in response to the gentleman from Alabama, would like to take note of Governor Engler's comment that he didn't care whether this extension of the moratorium took place by the deadline in October, whether or not we had the very, very complicated, very difficult, very controversial issue of allowing States to impose other States—businesses in other States obligations to collect taxes for them, the "no taxation without representation" problem, if you will.

And so, it's my hope that the governor, who is being, I think, more forthright about this than some of the others on his side of this issue, will recognize the importance of not allowing these unfair and discriminatory taxes to take hold of the Internet and allow us to proceed with that extension. And then, you know, I think everybody, in good faith, should continue to discuss the sales tax issue.

But let's not use what we all agree upon is necessary to do, the extension of this moratorium, as a vehicle to hold up the right thing to do in order to continue this debate on the other. I hope that we can extend that moratorium and continue to discuss what is a far more difficult problem of sales taxes.

Mr. BARR. Thank you. I appreciate the gentleman.

I would like to thank the four witnesses today, and thank all of the Members of the Subcommittee for their attendance.

The record will remain open for 1 week, if any of the witnesses have additional information.

I'd appreciate those witnesses who would like to address the issue of the now famous kiosk and the question of whether or not that kiosk would itself be a physical presence, such as would clearly establish the nexus to tax the transaction, and an effort to get around State tax would be fraud there. I'd appreciate the answer to that.

But any other information that the witnesses would like to present, the record will remain open for 7 days.

Thank you very much, gentlemen, for being with us.

[Whereupon, at 4:11 p.m., the Subcommittee was adjourned.]

A P P E N D I X

STATEMENTS SUBMITTED FOR THE HEARING RECORD

**Statement for the Record of
The Internet Tax Fairness Coalition
to the
Subcommittee on Commercial and Administrative Law,
House Judiciary Committee
Hearing on Internet Moratorium Tax Legislation
June 26, 2001**

Introduction

The Internet Tax Fairness Coalition (ITFC) is an alliance of retail, technology and communications companies and industry groups that promotes clear and simple tax rules for the borderless marketplace. We appreciate the opportunity to provide written testimony to the Subcommittee as it considers legislation to extend the Internet Tax Freedom Act.

As you know, the purpose of the moratorium on new and discriminatory taxes in the Internet Tax Freedom Act was: (1) to ensure that the rules that apply to other forms of remote commerce also applied to electronic commerce and (2) to allow time for the federal Advisory Commission on Electronic Commerce (ACEC) to study ways to simplify the current complex state sales and use tax system. The Internet Tax Freedom Act has never prevented the states from collecting sales and use taxes otherwise due on articles purchased over the Internet. The ITFC supports neutral tax treatment of Internet commerce; it does not support the creation of a "tax-free" zone for Internet commerce.

Allowing the moratorium to expire, however, would send a signal that it is now permissible to treat electronic commerce transactions differently from transactions using other channels. Extending the moratorium on multiple and discriminatory taxes thus is critical to ensuring neutral tax treatment for electronic commerce going forward.

The ITFC also supports a permanent ban on taxes on Internet access. A total ban on Internet access taxes was unanimously agreed upon by the ACEC and recommended to the Congress.¹ The basis for the ACEC's agreement was that the imposition of taxes on access to the Internet had a deterrent effect on the ability of lower income families to utilize the Internet's vast resources. The ACEC reasoned

¹ Advisory Commission on Electronic Commerce, Report to Congress, April 3, 2000.

that elimination of such taxes would help to close the so-called digital divide. We support the Internet Tax Nondiscrimination Act (H.R. 1675), introduced by Rep. Christopher Cox (R-CA), which would make permanent the ban on access taxes and on multiple and discriminatory taxes.

State Tax Simplification

Presently, interstate commerce and the economy are burdened by multiple, confusing and inconsistent state tax rules. Therefore, development of a simple and uniform system is critical for the continued development of the borderless marketplace enabled by electronic commerce.

One of the chief reasons the Supreme Court prohibited states from requiring out of state vendors with no physical presence in their state to collect and remit use taxes from in-state customers was because to do so would impose intolerable tax administration burdens on localized businesses participating in interstate commerce. Specifically, the Supreme Court found that the "many variations in rates of tax, in allowable exemptions, and in administrative and record keeping requirements could entangle . . . Interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose "a fair share of the cost of the local government." National Bellas Hess v. Dept. of Revenue, 363 U.S. 753 (1967); Quill, Corp. v. North Dakota, 504 U.S. 298 (1992).

Vendors, including those using the Internet, located in a single state that ship their goods to customers in other states must collect sales taxes from their customers located in their home state. Those vendors have no protection from administrative burdens imposed by the state in which they reside.

The ITFC believes that the states should simplify and unify their sales and use tax systems so that making vendors physically located in a single state collect and remit taxes for multiple states would not increase their administrative burden beyond what they already shoulder. Business then would work with the states to establish a reasonable mechanism for collecting these taxes on behalf of the states. Such a system also would reduce the compliance burden for those vendors currently under an obligation to collect and remit taxes for many states.

Some of the specific criteria that we believe would define a meaningful, simplified system include the following:

- A centralized, one-stop, multi-state registration system for sellers.
- Uniform definitions for goods or services that could be included in the tax base.
- Uniform and simple rules for attributing transactions to particular taxing jurisdictions.

- Uniform rules for the designation and identification of purchasers and transactions exempt from sales and use taxes, including a database of all exempt entities and a rule ensuring that reliance on such a database shall immunize sellers from liability.
- Uniform procedures for the certification of software that sellers may rely on to determine state and local sales and use tax rates and taxability and reliance on such software shall immunize sellers from liability.
- Uniform bad debt rules.
- Uniform tax returns, remittance forms, and filing and remittance dates.
- Uniform electronic filing and remittance methods.
- State administration of all sales and use taxes in such state.
- Uniform audit procedures, including a provision giving a seller the option to be subject to no more than a single audit per year using those procedures; provided that if the seller does not comply with the procedures to elect a single audit, any state can conduct an audit using those procedures; however, if elected, the single audit binds other states.
- Reasonable compensation for tax collection by sellers.
- Exemption from use tax collection requirements for remote sellers falling below a specified de minimis threshold of less than \$5,000,000 in prior year gross annual sales, or less than \$100,000 in any state during that prior year. This exemption would not, however, operate to exempt a seller with less than \$5,000,000 in prior year gross annual sales for any obligation to collect and remit sales or use taxes imposed by the state in which that seller is located.
- Appropriate protections for consumer privacy.
- A single, uniform statewide sales and use tax rate on all transactions on which a sales or use tax is imposed.
- For those states that impose a sales or use tax on digital products, an origin state default rule for transactions where the location of the customer is not disclosed during the transaction and that permits the seller to rely upon information given by the customer during the transaction.
- Appropriate bright-line nexus standards for business activity tax nexus purposes that limit business activity tax nexus to sellers that lease or own substantial tangible property in or have a number of employees or actual agents in the taxing jurisdiction for more than 30 days during the taxable year.

- Uniform dates, not to exceed two (2) in any calendar year, on which changes to sales and use tax rates may become effective, and a requirement that a state give at least 120 days notice before any change in its sales or use tax rate becomes effective.
- An effective enforcement mechanism that allows the United States Court of Federal Claims to resolve conflicts that arise with regard to interpretation of similar sales and use tax provisions of the different states.

Business Activity Taxes

E-commerce has an equally confusing effect on business activity tax nexus as it has with respect to sales tax nexus. We recommend that Congress include in any legislation dealing with Internet taxation a provision that would limit the states' ability to impose business activity taxes on out-of-state businesses to those businesses that have a non-de minimis physical presence in the state. We believe that current law imposes the same or a similar limitation. Specifically, to clarify "non-de minimis", a 30-day rule as a clear, bright line test is necessary. A bright line non-deminimum physical presence test would not impose any new restrictions on states' taxing power over out-of-state businesses, but rather would clarify the existing guidelines to prevent the potential for double taxation.

If the nexus thresholds for sales and use taxes are lowered, then enactment of bright line nexus thresholds for business activity taxes is essential. Lowering the sales and use tax nexus standards without at the same time explicitly clarifying the business activity tax nexus standards will leave companies with no defense to often spurious state income tax claims. It is evident from testimony by the Multistate Tax Commission at the Senate Commerce Committee hearings in March, that some states are anxious to pursue business activity taxes from out-of-state companies based on economic presence theories and abandon the physical presence test altogether.² It is critical, therefore, to enact appropriate bright-line nexus standards for business activity tax nexus purposes in conjunction with an extension of the moratorium and development of uniform and clear rules for the taxation of Internet commerce.

Conclusion

With the moratorium set to expire in October of this year, it is critical that Congress take the necessary steps to prevent multiple and discriminatory taxation on the Internet, and permanently ban all taxes on Internet access—this tax largely amounts to a tax on information and opportunity.

The ITFC and its members also are committed to dramatic simplification and unification of the sales and use tax systems at the state level. Simplification has always been a critical and essential component of this debate. The Internet Tax Freedom Act of 1998,

²Elizabeth Harchenko, Director Oregon Department of Revenue and Chair Multistate Tax Commission Testimony before the United States Senate Committee on Commerce, Science, and Transportation, March 14, 2001.

which imposed the moratorium, also created the ACEC. Legislation that passed the House by a vote of 352-75 in the 106th Congress (HR 3709) would have extended the moratorium and also laid out specific simplification criteria for the states. We urge the Congress to build on this history and adopt a moratorium extension with a purpose: to encourage states to enact meaningful sales tax simplification that does not pose an undue burden on businesses.

Congress should not consider exercising its power under the Commerce Clause to grant states the authority to impose tax collection responsibilities on out-of state businesses unless and until the states have demonstrated that they have enacted clear, simple and uniform rules. Only when the states have taken **all** the necessary steps to simplify and unify their sales and use tax systems (including appropriate uniform, bright line standards for business activity tax nexus), and Congress has considered the views of the business community on those steps, should Congress consider expanding the duty of remote vendors to collect and remit sales or use taxes.

We look forward to working with the Congress on these important issues.

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July 2, 2001

VIA AIRBORNE EXPRESS

The Honorable Bob Barr
 Chairman
 Subcommittee on Commercial & Administrative Law
 Committee on the Judiciary
 U.S. House of Representatives
 B-353 Rayburn Building
 Washington, DC 20515

Dear Chairman Barr:

At the June 26, 2001 hearing before the Subcommittee on the issue of extending the moratorium enacted under the 1998 Internet Tax Freedom Act, the issue of responsibility for collection of sales tax on purchases made via a kiosk was raised.

Specifically, the possibility that a consumer could go into a retail store, select a desired item, and order the item from a kiosk located in the store (or elsewhere) to avoid the collection of sales tax was discussed. In this circumstance, sales tax could not legally be avoided.

Under existing law a seller that has physical presence or "nexus" in a state, through property, employees, or agents, is required to collect sales tax on all of its sales made into that state. The presence of a remote seller's kiosk in a state, whether located in a store with a similar name or elsewhere, would constitute nexus in the state for the remote seller, thus legally obligating that remote seller to collect applicable tax on all its sales to customers in that state. The fact that the kiosk is located in a retail store is also likely to cause the store to be the agent of the remote seller, thus giving an additional basis for nexus.


Macy's • Bloomingdale's • The Bon Marché Bloomingdale's By Mail, Ltd. • Macy's By Mail
 Burdines • Goldsmith's • Lazarus • Rich's • Stern's Macys.Com • Fingerhut

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To the extent there are remote sellers trying to take advantage of this perceived "loophole," the remedy is for the state revenue authorities to enforce existing law. It does not require an overturning of the Supreme Court's decision in *Quill*, or any act of Congress or the state legislatures.

I would be happy to answer any questions or provide any additional information you or your staff have regarding this matter.

Very truly yours,



Frank G. Julian

FGJ:lms

Airborne Express No. 4519519115



COMMONWEALTH of VIRGINIA

Office of the Governor

James S. Gilmore, III
Governor

July 7, 2001

The Honorable Robert Barr
Chairman
Subcommittee on Commercial & Administrative Law
House Committee on the Judiciary
U.S. House of Representatives
B 353 Rayburn House Office Building
Washington, D.C. 20515

Re: Internet Taxation

Dear Chairman Barr:

Thank you for inviting me to testify before the Commercial & Administrative Law Subcommittee on June 26. I trust the panel provided the committee the consensus support needed to move HR 1675 forward. As all speakers testified, the moratorium against "multiple and discriminatory" taxes on the Internet and "access" taxes is non-controversial and should be extended permanently or at least for five additional years.

Since much of the question and answer session focused on the unrelated issue of sales taxes on the Internet, you asked panel members to submit supplemental commentary regarding the "kiosk" argument and other issues of interest. I would like to supplement my remarks on the "kiosk" question as well as the "level playing field" issue.

The "Kiosk" Argument Is Not Valid

Several pro-tax advocates have advanced the "kiosk" theory in support of harnessing sales taxes on all interstate commerce. According to the theory, "Main Street" retailers might convert every retail sale in their stores into a tax-free Internet transaction by allowing customers to use a computer terminal at the check-out and have their purchase delivered to their homes. Pro-tax advocates argue sales taxes should be imposed upon every Internet transaction in order to prevent this circumvention of intrastate sales taxes.

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The Advisory Commission on Electronic Commerce dismissed this argument as an exaggeration. The Commission determined that intrastate sales taxes remain effective under the *Quill* nexus paradigm for sales made by a retailer in a store, even if the retailer offers the customer an Internet alternative. Many retailers currently offer a home delivery option from their stores, but the physical presence of the stores and “kiosks” establishes physical presence for the imposition of sales tax.

The Commission’s Report proposed to preserve *intrastate* sales tax authority for state and local governments, in stores and kiosks, by codifying the *Quill* nexus paradigm. However, regarding *interstate* sales tax authority, the Commission’s Report proposed that Congress clarify what constitutes nexus in a cyber economy in order to create certainty for businesses engaged in interstate commerce. The Commission heard convincing testimony from the business sector about overreaching nexus determinations by state and local tax collectors, as well as the expensive costs to litigate these determinations on a case-by-case basis.

The model for nexus codification can be found in P.L. 86-272 (15 U.S.C. § 381). Some forty years ago Congress exercised its interstate commerce clause powers to codify nexus standards for purposes of *income* tax liability of businesses engaged in interstate commerce. The Commission proposed that standards be codified for purposes of *sales* tax collection responsibilities and clarified to encompass the newer business models and types of “presence” implicated by the cyber economy. Codification of the *Quill* nexus paradigm is a wholly reasonable approach that preserves *intrastate* taxing authority and protects *interstate* commerce from onerous tax burdens. Senator Judd Gregg has sponsored S. 664 in the Senate based upon the Commission’s Report to accomplish these dual objectives.

Incidentally, the Commission also called for Congress to amend P.L. 86-272 to clarify nexus standards for income tax and business activity tax liabilities of companies engaged in interstate commerce. I would like to underscore how critically important it is to the business community and the national economy for Congress to clarify these nexus standards.

Important Social & Economic Advantages of Internet Commerce

The “level playing field” argument also was raised during the hearing on June 26. According to this argument, the interstate commerce clause of the U.S. Constitution, as interpreted by *Quill*, has “distorted” the marketplace by relieving remote catalogue and Internet retailers of the burden of collecting sales taxes for state and local governments, while brick and mortar retailers must collect sales taxes for their state or locality.

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Since states have legal authority to enforce their use taxes directly against their taxpayers, the states have the legal authority to “un-distort” the marketplace to the extent they are truly concerned about unfairness. The point is that any “distortion” is really a result of the states’ reluctance to enforce use taxes. I have not detected any great effort by state or local governments to enforce their use taxes, except in the case of business taxpayers who are audited on a regular basis.

However, most state and local government representatives assert they cannot, as a practical matter, effectively collect use taxes and, therefore, they are requesting Congress to grant them the power to force businesses engaged in interstate commerce to assume the sales tax collection costs and burdens.

All concede that the playing field between brick and mortar retailers and Internet retailers is not level today. That is why the National Governor’s Association and other state and local government associations promised the Commission to create a “burdenless” system of sales tax collection for all “Main Street” and Internet retailers in America – to remove the issue of sales tax collection costs altogether. As I testified before the committee, I am not convinced the government lobbies have made sufficient progress for Congress to pass judgment on this project, and therefore, I am not prepared to endorse the purely hypothetical philosophical point that consumers and taxpayers would be best served were Congress to impose sales taxes on all interstate commerce.

I would urge Congress to consider who is making this argument as you consider the “level playing field” rationale. On the one hand, brick and mortar retailers who perceive a competitive price disadvantage due to tax policies in interstate commerce have every right to press this argument. On the other hand, too often the argument is a disguise of pro-tax politicians who are less concerned with market “distortions” than they are expanding the tax revenues of government. These politicians vote all the time for certain preferences of one business sector over another business sector, or one class of citizens over another class of citizens. Policy-makers such as governors, mayors, and congressmen regularly seek to foster positive social and economic advantages by enacting targeted tax deductions, public subsidies, and preferences – all of which constitute market “distortions.”

Consider these examples:

- Congress and many states have endorsed “enterprise zones.” Under this universally accepted policy, one business that locates on one block of a downtown or rural “Main Street” area might pay not income taxes, while one of its competitors located six blocks away might pay the full load of income

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taxes. This “unlevel” playing field, or market distortion, has been countenanced because of the important policy objectives of promoting economic revitalization of downtown “Main Street” areas and creating economic opportunities for those who live in those areas.

- By the same token, many “Main Street” areas have become the target of major public revitalization efforts and tax expenditures in the 1980s and 1990s. Some of these expenditures have come in response to official government subsidization for infrastructure around suburban malls in the 1960s and 1970s. In each era, policymakers distorted the marketplace in order to provide their citizens the kinds of social and economic opportunities they desired.
- Many businesses, including major brick and mortar retail companies, receive significant incentive grants of taxpayer dollars to locate in my state and other states across the country. These grants, which can amount to millions of dollars, subsidize the companies and their shareholders in order to attract jobs and investment. Again, this “unlevel” playing field, or market distortion, has been approved by legislators and governors around the country.
- Certain entertainment businesses, like sports teams and theatres, have convinced the public that they will bring special social and economic advantages to certain localities in exchange for the public’s subsidy of sports complexes and playhouses. Since these businesses compete against other local businesses for citizens’ discretionary spending on entertainment, these subsidies effect an “unlevel” playing field, albeit a widely accepted one.
- My state is no different from many other states in offering numerous targeted tax deductions and credits to encourage certain types of private investment. In Virginia it may be the coal industry and Internet service providers, while in Michigan it may be automobile manufacturers. Congress also has passed many targeted tax deductions and credits to reward certain types of businesses. Proponents of these special tax preferences justify them on the basis of the economic benefits they produce.
- The Bankruptcy Code treats some classes or types of creditors more favorably than others. At times the differential treatment of creditors is tightly wound in business logic, like the distinction between secured and unsecured creditors. But sometimes the differential treatment is the result of one business sector’s argument that a special protection is necessary for their particular market.

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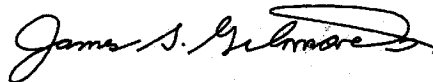
There are many other examples. The point is that there has been nothing sacred about the "level playing field" argument in dozens upon dozens of policy debates over the last century, though it is one of several legitimate policy considerations.

Thus, whether the Constitution's interstate commerce clause has created a market distortion that Congress must legislatively reverse should turn not on blind adherence to the "level playing field" proposition, but rather on consideration of the social and economic advantages to be gained for businesses and citizens and taxpayers through the full development of electronic commerce, as well as how tax burdens might inhibit the full development of electronic commerce.

How many small businesses, such as VaDiner.com, can be empowered to reach national and international markets once beyond their reach? How many elderly citizens can learn to shop on-line for pharmaceuticals and household goods without having to leave their homes? How many new jobs can be created in the technology sector – not just in the e-tail sector, but throughout the information technology sector that provides services and infrastructure to the e-tail sector and the consumers who shop on-line? How can America's dominance in the digital goods market be secured? These are the issues Congress should consider on their merits as you consider whether to expand sales tax collection burdens across interstate commerce and increase taxes on the American people engaged in electronic commerce.

There are many other points in this debate, but I thought it would be helpful to address these two issues which dominated the question and answer session before your committee. I would be happy to discuss these issues with you or your colleagues in further detail and thank you for the opportunity to address your subcommittee. Best regards.

Very truly yours,



James S. Gilmore, III
 Governor of Virginia

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